PENSIONS &

Investment Age

The newspaper of corporate and institutional investing

Public debt finances ESOPs

By Barry B. Burr

Brunswick Corp. and Unisys Corp. last month filed with the Securities and Exchange Commission to offer the first publicly registered debt to finance employee stock ownership plans.

The offerings might be the start of a trend toward public financings for ESOPs, giving investment banks a large share of the lending market.

Once it gets SEC clearance, Brunswick's ESOP will sell $100 million in notes — probably 15-year fixed-rate notes — to finance the purchase of 5.1 million shares of the Skokie, Ill., company.

As a result of the move, Brunswick's ESOP will become a leveraged one, and the amount of outstanding shares of Brunswick common stock it holds will increase immediately to 8% from 2%.

With the expanded ESOP and other arrangements, employees and directors now will hold 14% of the stock, bolstering a defense against potential takeovers by placing more shares in presumably friendly hands.

Unisys, which already received SEC clearance, expects to issue over the next four years $250 million in medium-term notes, probably in monthly offerings of $5 million each, to fund the newly created ESOP.

As a result of the offering, the company would contribute about 192,300 shares a month to the ESOP, based on Unisys's recent stock price of 26.

Unisys' ESOP isn't leveraged, despite the financing. The company, rather than the ESOP, is financing the transaction to contribute shares to the plan.

The ESOP won't change the amount of stock already being allocated to employees under existing benefits, according to Leon J. Level, vice president-treasurer for the Blue Bell, Pa., company. Unisys employees hold some 4.5 million shares, or about 3% of the 160 million shares outstanding.

The moves by Brunswick and Unisys to public financings will expand the market somewhat for ESOP lending beyond commercial loans and private placements with banks and insurance companies, according to executives at the companies and investment banks.

The possible market for ESOP debt, publicly or privately offered, is limited. Mutual funds are the only investors beyond banks and insurers to qualify to receive the 50% exclusion on interest income from ESOP debt, according to advisers involved in the offerings.

Herbert W. Krueger Jr., a lawyer with Mayer Brown & Platt, Chicago, tax counsel to

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CFOs' salaries reach $1 million

By Marcia Parker

The chief financial officers of ITT Corp. and Merrill Lynch & Co. broke the million-dollar salary mark in 1988, as corporations continue to increase the rewards for financial wizardry.

M. Cabell Woodward Jr., ITT vice chairman and chief financial officer, garnered the No. 1 spot, earning $1,034,484 in salary and bonus. Courtney Jones, Merrill Lynch executive vice president and chief financial officer, took second place, with an even $1 million.

They were the two highest-paid top financial executives among more than 1,000 public companies sampled by *Pensions & Investment Age*. In third place, at just less than $1 million, is James Riordan, director, vice chairman, executive vice president and chief financial officer of Mobil Oil Corp., who made $987,833.

The compensation paid to 54 chief financial officers and chief executives of the country's leading industrial and financial service companies is highlighted on page 31. Data for the survey came from the companies' 1989 proxy statements. Salaries include base pay and annual bonus, but exclude other long-term compensation. Whenever the long-term incentives were provided in the proxies, they are listed separately under "other" in the table.

Other highly paid financial executives include Ronald Arnault, executive vice president and chief financial officer at Atlantic Richfield Co., $843,222; James Stewart, executive vice president and chief financial officer of CIGNA, $791,000; C.H. Folley, vice chairman and chief financial officer of Ingersoll-Rand Co., $712,950; Ronald Doerfler, senior vice president and chief financial officer of Capital Cities/ABC Inc., $673,200; and H.W. Haynes, executive

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M. Cabell Woodward Jr., left, and Courtney Jones cracked the $1 million salary level.

The United Mine Workers union is digging in for a heated proxy battle with Pittston Co. management.

Miners lead proxy bid

Claim fight is unrelated to labor dispute

By Marcia Parker

GREENWICH, Conn. — Shareholders of The Pittston Co. will determine the outcome next week of one of the season's most bitter and unusual proxy contests.

It's a campaign by the United Mine Workers of America to win stockholder support for corporate governance resolutions the union is sponsoring, bolster shareholder value and garner a little sympathy for its long-running labor dispute with management.

Proxy season watchers are keeping close tabs on the Pittston-UMWA fight, which will be decided at the company's annual meeting May 10. Labor unions are relative newcomers to the growing institutional shareholder activism movement, which has been led mainly by a few public pension funds.

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Competition heats up
The yields on Treasury securities now rival those on real estate - 39

Differences disappear
The spread narrows between GICs and other similar instruments - 54

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LATE NEWS

Support up in early proxy tests

Shareholder resolutions calling for Consolidated Freightways Inc. to put its poison pill to a shareholder vote and Whirlpool Corp. to adopt confidential voting garnered strong votes, if not enough to win.

The two early tests may indicate shareholder support is growing for anti-poison pill resolutions and secret balloting.

At Consolidated Freightways, 48.3% of shareholders voted in favor of and 44.6% opposed the resolution sponsored by the California Public Employees' Retirement System. Because the 7.1% in abstentions are credited to management, which opposed the measure, the proposal won a plurality but not the majority needed. Support, however, did increase; last year, 42.4% supported the same resolution.

At Whirlpool, the vote in favor of the California fund's confidential ballot proposal was 36.7%; 54.4% voted against the measure and 8.9% abstained. It was the strongest showing this year in support of secret ballots.

Robert C. Brown talks called off

SAN FRANCISCO — A group of San Francisco investors ended discussions regarding a cash offer to purchase up to 85% of the outstanding stock of Robert C. Brown & Co.

Thrift Investment Services, led by Patricia Howe Ellison, had been negotiating with Robert C. Brown officials to acquire 75% to 85% of the publicly held fixed-income investment management and brokerage firm. Ms. Ellison had indicated a deal was near (*Pensions & Investment Age*, April 17).

A statement from Robert C. Brown officials said the parties "were unable to reach agreement on terms." B. Mason Fleming Jr., executive vice president at Brown, declined to elaborate.

Institutions form 3rd bond group

NEW YORK — A third group is being formed to fight for bondholders' rights, particularly in the high-yield area.

Reliance Insurance Co., New York, and T. Rowe Price Associates, Baltimore, are among the institutional members. Reliance reportedly is organizing the group, which has no name as yet.

The group joins two others formed in the past year to protect bondholder interests in the wake of heightened corporate restructuring activity. BondReview Inc., a Beverly Hills, Calif.-based bondholder service organization is geared to holders of high-yield bonds. The Institutional Bondholders' Rights Association was launched to fight the erosion of credit quality of corporate debt caused by restructurings.

Sponsors alter manager lineups

• TOPEKA — The $3.1 billion Kansas Public Employees Retirement System has shifted $430 million in assets to more evenly balance its growth and value investments, according to Marshall Crowther, executive secretary.

Hired last week were Loomis, Sayles & Co. Inc., Pasadena, Calif., to manage $150 million; and Delaware Investment Advisers, Philadelphia, to manage $280 million.

Terminated was Investment and Capital Management Corp., Rolling Meadows, Ill., which was managing a $280 million equity portfolio. Reimer & Koger Associates Inc., Merriam, Kan., had its $150 million equity portfolio terminated, Mr. Crowther said, but retains its $230 million direct placement portfolio and a $60 million portfolio that invests in Kansas companies.

Callan Associates Inc., San Francisco, consulted in the change.

• DALLAS — The Trammell Crow Distribution Corp. profit-sharing plan has hired Bear Stearns Asset Management to run its $2 million in assets in a balanced account, according to Bryan Keyes, vice president-finance.

The former manager, Wasatch Investment Advisors of Salt Lake City, was terminated because trustees wanted a manager that invests in blue-chip stocks and high-quality debt; Wasatch specializes in start-up and middle-market companies, Mr. Keyes said.

Connecticut fund fills new post

HARTFORD, Conn. — The $6.2 billion State of Connecticut Trust Funds hired John Winchester, former manager of trust investments at International Paper Co., as senior investment officer, a new position.

Mr. Winchester will assist Frank McDermott, assistant treasurer-investments, in overseeing the investment management of the fund. Mr. McDermott said Mr. Winchester will work on a newly created pension analysis unit that will be used in the selection and monitoring of investment managers and mutual funds. Mr. Winchester also will be the prime contact person on all domestic and international stocks and bonds.

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IRS to ease funding

New formula set for 401(h) contributions

By Fred Williams

WASHINGTON — A series of private letter rulings by the Internal Revenue Service has removed a major stumbling block for several employers to using 401(h) accounts to pre-fund retiree medical benefits, setting a precedent that is expected to be used by other companies.

Under 401(h) regulations, sponsors of defined benefit plans may fund retiree medical benefits on a tax-deductible basis as long as contributions to the 401(h) account do not exceed 25% of the aggregate employer pension contribution. As more plans have become fully funded, however, contributions have slowed and deductible contributions to 401(h) accounts have dried up as well.

Now, according to several actuaries and employee benefits specialists, the IRS said in a series of private letter rulings in March that an employer may determine the 25% limit, even where contributions are blocked by the full-funding limitations, by using the projected unit credit actuarial cost of providing benefits rather than contributions.

The change of position could stimulate interest by employers to initiate 401(h) accounts or to reinstate tax-deductible contributions to existing accounts to start funding potentially huge retiree medical liabilities.

Estimates of the total retiree medical liabilities in the United States range from $200 billion to $2 trillion.

Fred Rumack, director of tax and legal consulting at Buck Consultants Inc., New York, said the firm has been recommending its pension clients "move quickly" to obtain a letter ruling from the IRS because the letters already issued, while they might be a precedent, may not be relied upon by other pension plans.

"To the extent companies have their own private letter rulings, this represents one of the best ways to fund post-retirement medical liabilities," said Mr. Rumack. "The assets can be commingled with pension assets for investment purposes, but it is a separate account. Companies should be able to accumulate substantial assets in a relatively short period of time depending on the size of the company."

The IRS rulings are so recent many pension plan executives have not heard about them.

William J. McHugh Jr., director-trust investments at CIBA-GEIGY Corp., Ardsley, N.Y., said his company considered various options for funding its retiree medical liability, which he described as "good sized." The company has considered various methods, such as company-owned life insurance, a 501(c)9 trust and a 401(h) account.

Mr. McHugh said he hadn't heard of the IRS actions, but that because of the rulings, the 401(h) "might be attractive to us, since, like most companies our size, we have a large liability."

He said the company's normal pension costs amount to about $20 million, which would allow contributions of $5 million in a 401(h) account.

"This is fairly new. We had heard that people had petitioned the IRS for private letter rulings. We will look into it. It is one way to begin funding for this liability," he said. Even if CIBA-GEIGY begins funding using a 401(h), he said, the assets would amount to "a drop in the bucket" compared with the overall liability.

Sunny Oberoi, director-pension fund investments at Pacific Gas & Electric Co., San Francisco, said

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Banks preparing for fight on BICs

By Fred Williams

WASHINGTON — Banking and insurance industry lobbyists are squaring off for a fight over a two-year moratorium on federal guarantees for bank investment contracts contained in the House thrift rescue bill.

The issue probably will not be resolved until after Memorial Day, when House and Senate conferees meet to resolve differences between their respective thrift bills.

In April, the insurance industry launched a broadside attack in Congress against bank investment contracts, which are taking a growing portion of the insurers' lucrative guaranteed investment contract market.

The American Council of Life Insurance succeeded in getting a key House Banking subcommittee to adopt an amendment imposing a two-year moratorium on federal pass-through guarantees of $100,000 per participant on BICs.

In addition, it is unclear whether the House provision would strip the $100,000 per participant coverage from jumbo certificates of deposit. Numerous union pension funds have channeled job-creating investments through jumbo CDs, as the bank issuing the CD agrees to provide construction financing for projects built with union labor.

While an aide to Rep. Charles Schumer, D-N.Y., who sponsored the House amendment, said wording in the bill's report will make clear only BICs are affected, a banking lobbyist said a court would look to the legislation's wording before examining a committee report.

Although the banking industry had anticipated an attack on BICs, bankers were caught off guard with the timing of the measure and were scrambling to formulate a policy response. The full House Banking Committee was expected to vote last week on the House bill, H.R. 1278, but a counterattack by the banking industry probably will wait until the two versions of the bill go to the conference committee.

The two-year moratorium would affect pass-through insurance coverage provided by the Federal Deposit Insurance Corp. and the Federal Savings and Loan Insurance Corp. The moratorium would hold while the Department of Treasury conducts an 18-month study of the federal deposit insurance program and for an additional six months while Congress considers the study.

The provision would bar the FDIC and the FSLIC from extending pass-through coverage from April 6 — the date the amendment was adopted — through the duration of the moratorium to individual investors in unit investment trusts or to individual pension or profit-sharing plan participants. It also would ban pass-through coverage for any bank instruments issued after April 6.

An effort to pass a similar provision in the Senate Banking Committee failed. Sen. Christopher Dodd, D-Conn., sponsored the amendment there, but settled for a six-month study on the pass-through of federal deposit insurance.

The insurance industry has been increasingly critical of banks offering guaranteed investment contracts, a virtual monopoly for insurers until two years ago.

Banks were capturing a large portion of the $150 billion guaranteed investment market, especially in the shorter maturities. The growth of the banks' participation paralleled that of the defined contribution and 401(k) market. According to one insurance company estimate,

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Funds bet on lottery proceeds

By Curtis Vosti

INDIANAPOLIS — State legislators are betting a lottery could provide the windfall to fill an estimated $5.6 billion shortfall in Indiana's public pension funds.

If so, it would be the first time lottery proceeds would be earmarked specifically to fund pension funds, although a few states put lottery money into general operating accounts, which could be used for pension funding.

As the Indiana legislative session approached its end April 30, a conference committee was working on a lottery bill that would direct about $35 million annually toward the state's unfunded pension liabilities.

In 1988, Indiana voters approved a constitutional amendment to overturn a ban on lotteries, parimutuel betting and other forms of gambling. The authorization for a lottery has passed both houses of the Legislature, with differences to be ironed out by the conference committee.

State Rep. Brad Fox proposed the pension liability payments, and said he expects three of the four members of the conference committee to support it. Mr. Fox said the plan would amortize the deficit over a 40-year period to cover the unfunded liabilities of the state police, firefighters, and teachers pension funds. The balance of the lottery revenue — after the $35 million pension payment — initially would be spent on an infrastructure program, if Mr. Fox's proposal is accepted.

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Edelman sets crosshairs on Europe

By Margaret Price

For American investor Asher B. Edelman, Europe is the new land of opportunity.

Having already cut a wide swath through corporate America as an investor-raider, Mr. Edelman last year officially began addressing perceived undervalued situations in Europe; to do so, he moved to Lausanne, Switzerland.

Exporting hostile takeovers and treading on what Mr. Edelman admits is "someone else's backyard" is a bold stroke.

But the dapper 49-year-old investor, who says he studied in Europe during the 1950s, and worked there in the '60s, actually started "looking at European companies about four years ago. I found more and more situations that were considerably cheaper . . . than American companies," he said in an interview in his New York office.

"In several countries — England, France and Belgium — there are what I consider to be very equitable shareholders' rights, very reasonable approaches to acquiring companies and reasonable approaches to defending managements who would rather stay in companies," Mr. Edelman said.

In the United States, Mr. Edelman went after such companies as Lucky Stores Inc. and Burlington Industries Inc., using the capital markets and assets from companies he controlled and some of his and his friends' money.

For his strategic block investments in Europe, however, Mr. Edelman is welcoming institutional and individual investors through two funds: Felicitas Partners, founded in March 1988 and designed for U.S. investors; and Edelman International Ltd., founded last August in the British Virgin Islands and intended for off-shore investors.

Although Mr. Edelman has raised only about $40 million — $25 million for Felicitas and $15 million for Edelman International — performance has given Mr. Edelman fodder for crowing. At year end, Mr. Edelman claimed Felicitas Partners had a return for the 10 months of 122.5%, netting 92% to investors. After four months, Edelman International had a 34% return, netting 25.5% for to investors, he claimed.

Mr. Edelman said two other public investment funds managed by him also did well: a 28.88% return last year, with a 19.54% net return to investors for Plaza Securities Co., a New York broker-dealer, and a net return of 50.97% in 1988 for Plaza International Ltd., an offshore fund founded in January 1988, and based on the British Virgin Island of Tortola.

Asher Edelman is trying to interest U.S. institutional investors to invest in funds he controls to take advantage of the corporate opportunities he sees in various European countries.

The source of these returns included investments in Lonrho PLC, Payless Cashways Inc. and Centel Corp.

Thus far, European institutional investors have been easier to sell on takeover funds than those in the United States, Mr. Edelman said. But he thinks U.S. attitudes might be changing slowly.

Particularly in light of his performance, he said investments in foreign takeovers might appeal more to U.S. pension funds than do investments in U.S. takeovers.

"I think (pension fund managers) have a different attitude about what goes on abroad," said Mr. Edelman. Without identifying which ones, he said "there have been pension funds that have said: 'Maybe we'll take a harder look (at these investments). They're not on our home base, and they are something that might make sense for us.' "

Mr. Edelman landed Genesee Partners of Bellevue, Wash., as one of the first U.S. institutional investors in Felicitas Partners: Genesee, a fund with about $28 million under management, reinvests its money with other money managers; it put $1 million in Felicitas Partners this year as Genesee's first European exposure, said Richard McLean, a Genesee general partner.

But successes notwithstanding, European investing hasn't been a breeze for Mr. Edelman. For one thing, he has had to digest a bevy of different cultural and legal rules of corporate takeovers — such as "there are no highly confident letters" (indicating the acquirer is confident of obtaining financing) in England, and anyone launching a takeover bid there has to have a 100% commitment for the money. He also cites the different rules about reporting requirements and holding periods for takeover bids.

Investing in Europe also has meant Mr. Edelman has had to modify his approach. The man often viewed as a media hound in the United States has tried — albeit fairly unsuccessfully — for a lower profile in Europe and, where possible, has tried to meet quietly with managements of European companies in which he is interested.

Yet, pitfalls remain. And like it or not, Mr. Edelman hasn't stayed out of the limelight. To date, he has been involved in two public deals in Europe. The first was with Britain's Lonrho PLC, where he surfaced last September with a 5% stake. In so doing, he locked horns with Lonrho's formidable chief executive, R.W. "Tiny" Rowland, who was determined to identify the person buying his company's stock.

The situation quickly got messy. According to Mr. Edelman's interpretation of the events, Australian beer mogul Alan Bond also

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The world of indexes is getting bigger

High correlation exists among bond benchmarks

By Fred Williams

The four major fixed-income indexes are so similar they are nearly identical, a study by two University of Notre Dame professors concludes.

But while the study indicated no single benchmark is completely accepted, the indexes produced by Shearson Lehman Hutton Inc. have become almost ubiquitous for performance measurement and management of bond index funds.

The firm's government/corporate and aggregate indexes are used by upwards of 80% of bond portfolio managers, industry experts estimate. The aggregate index, which includes mortgage-backed securities, is gaining favor among bond investors.

The Notre Dame study of the bond market between 1980 and 1987 found an extremely high correlation among the bond indexes, just less than 100%. Indexes included in the study were the Merrill Lynch Domestic Government/Corporate Master Index, Salomon Brothers Broad Investment Grade Index, the Shearson Lehman Government/Corporate Bond Index and the Ryan Financial Strategy Group Treasury Index. The study was conducted by Frank K. Reilly and David Wright, finance professors.

Ronald Ryan spent six years at Lehman Brothers Kuhn Loeb (the forerunner to Shearson Lehman Hutton) before starting Ryan Labs Inc., New York, in 1982; he either designed or supervised more than 70 bond indexes, including the government/corporate index. He said one reason the indexes look and act alike is they have become dominated by the government bond sector. The government sector comprised 58% of the Merrill Lynch index, 54% of the Salomon BIG and 73% of the Shearson Lehman index in 1988.

Mr. Ryan believes the trend will accelerate primarily because Treasury debt continues to mushroom.

"The bond market is becoming government-based; as a result, indexes are government-based," he said. "Performance measurement says that people can't beat the market. By observing that, it is pretty obvious that market products, index products, make a lot of sense.

"The Notre Dame study says that all bond indexes look alike; their correlations are almost 100%. That says it makes no difference which index you pick," Mr. Ryan said.

"They all measure the same thing: interest rate volatility. That is the big message.

"Yet few people understand how bond indexes are created, their mechanics, their behavior patterns. Can you imagine a football team going out on the field of battle and they don't know who they are playing?

"Bond managers do not understand bond indexes very well. They have never designed them, they don't understand the mechanics and Wall Street doesn't provide good information. It's usually monthly, it's usually sketchy, it's usually delinquent. Can you imagine with equities if the S&P 500 came out monthly and delinquent?"

Among the other findings of the Notre Dame study:

- A bond index might be tracked using fewer issues than that contained in the major indexes.

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More firms vying in global arena

By Margaret Price

After nearly two decades as the dominant measurement of world equity market performance, Morgan Stanley Capital International's Europe Australia Far East Index is facing intensifying competition.

That means investors now have a wide choice of indexes against which to measure the performance of their international managers and their total portfolios, or on which to base passive international portfolios.

In the past few years, a number of firms — including Goldman, Sachs & Co., Salomon Brothers Inc. and Shearson Lehman Hutton Inc., all of New York — have begun to try to capitalize on the growing investor interest in both international investing and passive strategies.

In addition to bolstering the sponsoring brokerage firms' volume of stock trades, the new index offerings could give some free publicity to the firms' general brokerage and investment banking activities.

The FT-Actuaries World Indices, a joint venture of Goldman, Sachs, Financial Times Ltd. of London and County NatWest/Wood Mackenzie, London, made its debut at year-end 1985. The Salomon-Russell Global Equity Indexes, formed by Salomon Brothers and Frank Russell Co., Tacoma, Wash., bowed in July 1987.

This fall, Shearson Lehman Hutton, in conjunction with Dow Jones & Co., plans to unveil its Dow Jones World Index, according to Shearson's Christopher Hayes, project manager for the international equity index.

The firms' efforts face a hard battle, as the EAFE clearly is maintaining its dominance, at least in the United States.

Mark Sladkus, vice president of Morgan Stanley & Co., New York, claims "close to 100% of international money managers use our indexes," either with passive or active approaches. The indexes are used for at least $9.6 billion in tax-exempt assets used in passive strategies, he said.

Said Duncan Fordyce, senior vice president, InterSec Research Corp., Stamford, Conn.: "The bulk of money managers continue

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How major indexes rack up

Bond

Vendor	Pricing	Weighting	Daily availability	No. of issues	Minimum maturity (years)	Min. par value ($ mils.)
Merrill Lynch	trader & model	market value	yes	4,900+	1	10
Ryan	market	equal	yes	7 Treasuries	2	—
Salomon	trader	market value	no	4,500+	1	25
SLH	trader & model	market value	Treasury index only	6,000+	1	1

Source: Frank Reilly and David Wright, University of Notre Dame

International

Vendor	Assets tracking indexes ($ bils.)	Number of stocks	Cost*
Goldman, Sachs	4	2,500	1.79%
Salomon	1	1,687	1.28**
Morgan Stanley	8.8	1,021	1.45

* of implementing a $100 million equity portfolio
** for the 600-issue Primary Market Index

Source: Companies and various reports

GLOBAL INSTITUTIONAL INVESTING

Japanese to keep assets flowing

By Curtis Vosti

TOKYO — A glut of investment capital is expected to be available from Japanese investors in the immediate future, as an economic restructuring coincides with tremendous growth in pension assets, tokkin funds and available personal savings.

Outlets for these funds are expected to be in a growing Japanese market and internationally, though the relative amount of investment in the United States is expected to decline.

Japanese pension funds, estimated to be about $200 billion in 1989, are expected, as the population ages, to grow to more than $600 billion by 1995, according to Mark Ira, vice president and senior investment officer with Yasuda Bank and Trust Co., Tokyo.

The aging population, and expected increased pension costs is putting more emphasis on performance, according to a spokesman for Banker's Trust Corp., New York, which should mean a greater share of foreign bank management of the tokkin — or surplus corporate cash — funds.

The Banker Trust's spokesman said the pension and tokkin market should triple between 1988 and 1993. At the end of 1987, the tokkin market was $229 billion, according to the Japan's Trust Bank Association. According to the Nikko Research Center, New York, the tokkin market grew by $42 billion in 1987 and by $27 billion in 1988.

These investment assets are expected to be joined by a boost in available personal savings that will mature in the next three years.

Personal savings available for investment, in postal savings, government bonds, bank debentures and loan trusts, are expected to be about $205 billion in fiscal year 1989, $375 billion in fiscal year 1990 and $204 billion in 1991, according to Daiwa Securities America Inc., New York.

Because the government is trying to pay off its debt in advance of future obligations due to a rapidly aging population, it is redeeming more bond issues than it is issuing, according to Michael Longthorne, who works in Japanese equity sales for Robert Fleming Inc., New York. He estimates the reduction in the bond market in fiscal year 1989, which began April 1, to be about $16.2 billion.

As approximately $74.5 billion in bonds, much of it high-coupon debt issued after the oil shock of 1979, comes due, he said, institutions, especially cash-strapped insurance companies, may turn to foreign bonds. Exchange rates will also be a factor, he said.

"The key thing is we don't know how institutions are going to react," Mr. Longthorne said.

Daiwa officials think a large portion of this available cash will go into the stock market, as law changes have been made to encourage individual investment in the market. Among the changes are: a lower capital gains tax that should encourage wealthy individual investors and a reduction to 30 basis points from 55 basis points on the transfer tax.

"For the long term, the stock market will continue to focus on structural change in the Japanese economy and its new directions. In this light, development of infrastructure will remain the most important market theme," according to Daiwa.

According to Mr. Ira, this restructuring push is akin to the era of U.S. interstate highway development in the early 1960s. The idea is to structure the Japanese economy more to a domestic demand push from an export push. Laws making it easier for companies to restructure are along these lines, he said, and the overall effect will be positive on the Japanese market.

"This translates into

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1988: A good year for world markets

	Equity return*	Market capitalization (in U.S. $ mils.)
Japan	38.9%	3,840,178
United Kingdom	5.9	718,058
West Germany	32.8	240,790
Switzerland	22.9	147,853
Italy	22.5	135,125
Australia	12.0	133,965
Spain	15.5	66,887

* local currency terms without dividends reinvested
Source: Morgan Stanley Capital International

Real estate still magical

Japanese real estate investment in the United States is expected to remain robust, but plateau.

The Japanese invested $16.54 billion in U.S. real estate in 1988, compared with $1.86 billion in 1985, according to Jack Rodman, a partner of Kenneth Leventhal & Co., Los Angeles, which recently published a study of Japanese investment in the United States.

"Assuming no economic or political catastrophes, we expect 1989 Japanese (real estate) investment to be in the magnitude of $13 billion to $16 billion," the study says.

Mr. Rodman said the amount — which doesn't include another $2 billion worth of projects that may come on line in late 1989 — is tempered by competition from European markets. There will continue to be increased diversification geographically, away from "trophy properties" in Honolulu, Los Angeles and New York, and by property type, including acquisitions of shopping centers and other retail facilities and business parks, he said.

He said he expects the money-rich Japanese pension funds to become more involved, in part because of liberalization of Ministry of Finance rules regarding foreign investments.

Japanese banks also should become more involved, Mr. Rodman said, as they manage more Japanese pension fund assets and as they become more competitive with U.S. financial institutions in financing real estate acquisitions.

"Japanese banks that have been here a couple of years are becoming more comfortable in their analyses of real estate transactions," he said. "At first, all they wanted to do was put a mortgage on a completed building. Now, they are much more aggressive."

He said the banks will begin to function as intermediaries, matching Japanese and U.S. development and construction companies in joint venture projects.

Mr. Rodman said the importance of developers to the Japanese was driven home to him recently, when Takehiro Takuma, a deputy general manager from Mitsubishi Bank, Ltd., Tokyo, said that for Japanese Banks, the old real estate maxim "location, location, location" has been changed to "developer, developer, developer."

— Curtis Vosti

Australia chaos

New pension tax creates confusion

By Greg Bright

SYDNEY, Australia — The government's wishes to wean the nearly $80 billion pension industry from the public purse and regulate and minimize tax breaks for the pension system has left Australia with a maze of requirements for fund trustees, managers and consultants.

The government introduced a 15% tax on investment income and a 15% tax on employer contributions. It also created new "reasonable benefit" limits to be phased in over a number of years restricting lump-sum payments to executives.

The changes, announced in the May Economic Statement of 1988, were felt in the stock market — which rose 10.9% last year in local currency terms, according to Morgan Stanley Capital International, New York. Coming as it did on the heels of the October 1987 market crash, the changes have meant virtual abandonment by institutional investors of smaller-capitalization companies and more speculative companies with poor earnings. Most fund managers have been overweighted in the top 100 by market capitalization stocks.

Institutions now are competing for leading industrials and other companies that paid full or near-full rates of company tax. As part the government had introduced a "franking" system whereby dividends were fully or partially franked when paid by companies that had paid company tax. The franked portions were then deducted from the income tax liabilities of stockholders.

Thus, the pension funds could reduce or eliminate the investment income tax by investing in the stocks of companies whose dividends had been "franked" because the company had paid tax.

Most of the older and larger corporate defined benefit plans escaped the contributions tax last year because the large surpluses amassed in the early 1980s' bull market made contributions unnecessary.

But Australia is still swirling in the winds of uncertainty; although the rules were applicable since July 1988, actual legislation had yet to be introduced to Parliament as of mid-April. The Treasury Department officials drafting the legislation appear to have difficulty backing government claims that pension fund participants will not suffer because of the changes.

Martin Stevenson, deputy managing director of Mercer Campbell Cook & Knight, a consulting and actuarial firm, said pension fund trustees had become increasingly concerned about being forced to comply with guidelines

Europe 1992

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U.K. traditions languish

By Margaret Price

In the United Kingdom, time-honored patterns of institutional investing are beginning to crack, if not crumble, amid growing competition among money managers and the rising presence of pension fund consultants.

Changes are evolving slowly. More and more, institutional investors — particularly U.K. pension funds — are embracing new investment ideas that often originated from the United States. Along with the growing wave of U.S. pension fund consultants setting up shop in the United Kingdom in the 1980s, came ideas ranging from use of quantitative strategies to specialty money managers.

Clearly, one of the more popular of these imports has been the use of indexing investments. With this strategy, investors saw they could gain the assurance of tracking market indexes with reduced investment costs.

There were, of course, deterrents that continue to weigh on indexing's popularity. One was the chance of forfeiting better-than-market returns. Today, many believe indexing is still in its trial-run stage, and experts say about 5% of U.K. pension funds' assets are now indexed. That allocation is widely expected to rise.

James Woodlock, a director of London-based Barclays de Zoete Wedd Investment Management Ltd. and head of BZW's index funds team, predicted "this is going to be a bumper year" for indexing. BZW manages about $1.36 billion in its commingled index funds. Mr. Woodlock expects that amount to about double in the coming year.

BZW's segregated indexed funds now total about $5 billion, and Mr. Woodlock hopes that amount will grow about 50% in the coming year. Word-of-mouth has helped trigger a "domino effect," he explained. Now that some "people have experienced indexing and found it to be a good strategy, more (investors are) becoming willing to try it."

A desire to boost performance has been one major attraction for indexing. But that wasn't the rational of the Shell Contributory Pension Fund, London, which "had been performing well," reported Alan Hall, the fund's investment manager.

According to Mr. Hall, Shell Contributory's large size — about $6.8 billion — was a main incentive for indexing. After the fund "grew quickly" with the equities portion rising to about $3.4 billion from some $680 million in four years, "we decided to index three-quarters of our U.K. equity portfolio," said Mr. Hall. That process began in August 1987, and was completed in April 1988.

Last year, Shell Contributory also began "using indexing (overseas) in a limited way," said Mr. Hall. He said that about 5% of the fund's overseas equities holdings — totaling about 19% of Shell's pension fund assets — are indexed.

At least some market participants believe indexing of non-U.K. investments may prove quite popular. The rationale: Few investors can be expected to understand the foreign markets the same way they know domestic markets. Japan's market performances have dramatically underscored the problem. In recent years, many London money managers "have been light in Japan, with the result that our international performance has fallen behind" indexes, conceded David Barker, managing director of Hill Samuel Investment Management Ltd., London.

According to The WM Co., an Edinburgh, Scotland-based performance measurement consultant, U.K. pension funds, on average, underperformed overseas markets 5% annually; against the Japanese market, they underperformed 9.4% per year.

To help rectify such problems — and to expand clients' choices in how they invest abroad — Hill Samuel and some other money managers have begun offering indexed products for foreign markets.

For example, this past April, Hill Samuel unveiled four index offerings. Three were regional indexed funds, separately for North America, the Pacific and continental Europe. The fourth is a broad-based international indexed fund. Attesting to the apparent attractiveness of these funds, some $75 million already has been invested in them by 15 to 20 U.K. pension plans, said Mr. Barker.

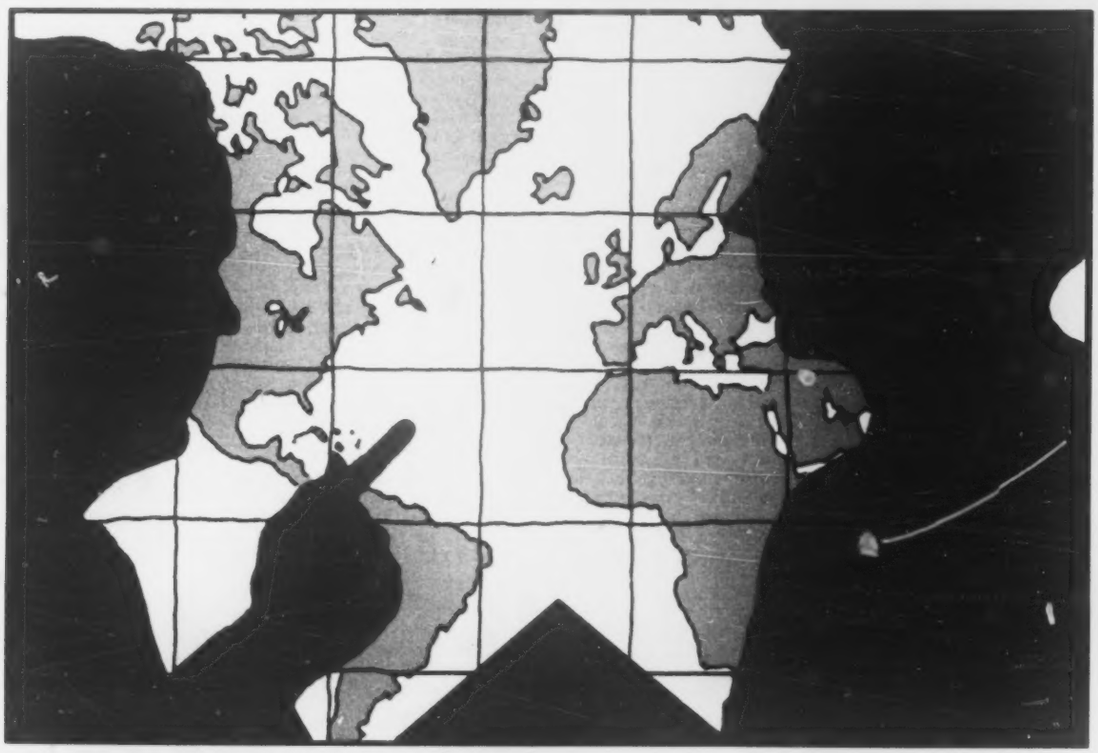
Inevitably, the U.K's affinity for other new investment tools and processes will vary. Graham Jordon, a performance consultant in the London office of The WM Co., thinks international indexed funds could catch on — "possibly more than U.K. indexed funds." He also sees quantitative ideas selectively catching on. "We'll be watching the U.S. to see which ones have worked and which haven't," he predicted.

Besides quantitative offerings, U.S. pension fund consultants have imported notions of specialty management. These have increasingly caught on in London, where investment managers have seen specialties as a growth business area. Some specialty boutiques also have popped up to offer expertise in particular disciplines. Many balanced managers also now market such prowess as European equities, Pacific Rim equity markets, or even quantitative products.

Schroder Investment Management Ltd., London, is a balanced manager. "But to do our job properly, we have (traditionally) needed to have specialists covering all the markets in which we invest," said Brian Wood, a director of the firm. More recently, Schroder has "begun marketing these specialists as specialists," he said. "And now the firm cannot only provide a total product but also products."

Mr. Wood added, however, "it's still very much the minority that hire us for specialities." And given the higher cost of using specialists, "only very big funds can consider specialization." Thus, his firm's opinion is that "we don't see this as a long-term powerful trend."

Many U.K. pension funds may be too small to consider using consultants, pointed out Mr. Jordon. But some other institutional investors, mostly notably U.K insurance companies, appear to be simply ignoring at least some of the trends influencing larger U.K pension funds. Russell Smith, marketing manager for R. Watson & Son, consulting actuaries in Reigate, observes U.K. insurance companies tend to have "unexciting strategies but solid perfor-



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German institutions eye new paths

By Margaret Price

BONN, West Germany — West German institutions, which have long preferred to invest "safely" in bonds and real estate, appear to be moving toward a social and economic crossroads that could lead toward greater interest in equities.

Demographics is one key underlying issue. German baby-boomers, who are maturing into some of today's corporate decision-makers, escaped the financial ravages of wars and inflation their parents endured. Many Germans say today's 35- to 45-year-olds carry less concern about equity investments than do older Germans.

At the same time, the labor force is inching toward retirement and likely will want employers to establish fully funded separate pension plans — possibly similar to existing plans in the United Kingdom or the United States.

On the economic front, West Germany is facing mounting competitive pressures, both domestically and internationally, that could well demand "riskier" investment strategies.

Again, demographics has a role. Analysts say insurance companies — West Germany's largest institutional investors, with roughly $328 billion in assets — are paying out increasing sums to aging claimants. During the 1980s, they've decided to try to get back some of those payouts.

One solution: setting up money management operations, sometimes jointly with banks, sometimes in competition with them.

"This trend has already started," said Michael Zapf, managing director at Mat Main Anlage Trust, the mutual fund subsidiary of the Matuschka Group, Frankfurt.

Some analysts believe this development could help expand insurers' own investments in equities, which is said to average about 5% of total investments today, although the legal limit is 20%.

Meanwhile, fears of international competition loom. As trade barriers topple, some insurers fear their business may become less competitive compared with that of foreign insurers. Specifically, if competitors can earn higher returns on their investments, they presumably would charge lower premiums and undercut German insurers' prime business.

The United Kingdom provides a glaring example of the potential threat. In that country, the life insurance clients of The WM Co., an Edinburgh, Scotland-based performance measurement consultant, have an average of 42% of assets in U.K. equities and 9% in overseas stocks.

For his part, Gregor Gielen, senior vice president of BHF Securities Corp., New York, believes German insurers will step up equity investments to the legal limit in the coming decade.

"From here we assume those riskier investments should grow faster than total assets. It should be step by step, as (insurers) gain more confidence in this and as foreign competition demands higher exposure to stocks and their substantially higher returns."

For a variety of reasons, Mr. Gielen sees the West German stock market rising 40% to 60% in the next three years (although he's not bullish for the very short term). In his view, the German market is 25% to 30% undervalued in terms of 1990 corporate earnings. "So as time goes on, the market should pick up," he said.

If such market bulls are correct, other investors besides insurers should notice the development. One particular group could be German corporate pension funds.

Today, the bulk of German companies still retain their book-reserve system of pension funding, whereby the pension reserves are retained as working capital in a company. According to Brigitte Hiegemann, a consulting actuary at Buro Dr. Heubeck, in Cologne, German company pension assets total 162 billion deutsche marks, of which two-thirds is in book reserves.

But various socioeconomic trends, including the anticipated expanding number of retirees and declining pool of young workers, could encourage companies to set up separate employee pension funds. "Given the (expected) scarcity of workers in the early 1990s, unions will be the driving force" propelling companies to set up separate pension plans, said Mr. Zapf.

If this occurs, many analysts expect companies would widely use the country's so-called "spezialfonds," separate investment pools set up by one or a limited number of organizations — as opposed to individuals — and run by money managers. According to Mr. Gielen, they have the tax advantage that their capital gains and interest income need not be reflected on sponsors' balance sheets.

In recent years, special funds have emerged as Germany's "fastest growing institutional sector," said Mr. Zapf. "Often, German insurers at least have invested directly in government bonds and real estate. But they've used special funds as professional and convenient ways to invest in equities."

According to Bundesbank figures, assets of special funds totaled about $47 billion as of January. They average a 23% allocation in German equities, 51% in German bonds, 8% in foreign stocks, 9% in foreign bonds and 9% in cash.

Many think the creation of more German corporate pension funds — if that does occur — would naturally produce more special funds, and in turn more equity investments. And in the bullish scenario, each step feeds on the other. More equity purchases presumably would boost share prices, which would encourage more companies to issue stock, thus expanding market capitalization and the overall attractiveness of German equities.

But all this may not happen quickly or imminently. Even though many analysts agree German fears of risky investments may be waning, they disagree on what market implications this bodes.

Mr. Zapf illustrated the difficulty in predicting the future of German investors. Referring to maturing baby-boomers who might be individual investors, he said: "We never have had that type of individual" who is earning a good salary and obtaining "an inheritance on top of that. We don't know what his investing patterns would be." ■

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Spanish market poised for boom

By Curtis Vosti

MADRID, Spain — Growth and development seem to be in the wind for the Spanish market.

While Spanish institutional investors seem to be heavily on the sidelines, and the market has flattened after a 1986-'87 growth spurt, strong economic fundamentals are making it attractive for foreign investors.

Spain was the fastest growing market in 1986 and 1987, with local currency-measured gains of 91% and 13%, respectively, but it was the second worst performing market for the year ended March 31, 1989, (up 20.8% in local currency), according to Michael Perelstein, international strategist for First Chicago Investment Advisors.

This leads the contrarian-minded First Chicago to triple-weighted investments in Spain. The Morgan Stanley Capital International weighting for Spain is 1.4%. One reason for First Chicago's heavy weighting, Mr. Perelstein said, is double-digit earnings are common for many Spanish companies.

As far as the Spanish economy goes, "I'd be hesitant to dub it a backward economy, but in many cases it is," said Carol Franklin, vice president of Scudder, Stevens & Clark, New York.

The Spanish market still is in the underdeveloped stage, she said, as evidenced by the proportion of stock market capitalization to gross national product. While the United Kingdom and Japan have proportions around 85%, Spain's is less than 25%.

But that should grow, especially as the private pension system takes hold, according to Mr. Bartolome, chairman of Banco Espana, Barcelona, the wholly owned subsidiary of Prudential Asset Management Co.

Mr. Bartolome said laws promoting the pension system were passed in 1986. But because regulations were issued only this past December, with delays expected, pension growth will not be felt until the 1990s.

"Everybody expects this is a market that is going to explode," Mr. Bartolome said, estimating that by 1995, it could reach $15 billion. The current, pre-legislation pension market is "very small, just a few hundred million dollars," according to Wilson Phillips, of the asset management arm of UBS Phillips & Drew International Investment, London.

Mr. Phillips said factors may limit more optimistic estimates of the pension fund growth. For one, he said, tax incentives encouraging the formation of the pension system limits a company's annual tax-free contributions to $600,000. Also, employees currently hold majority control over the selection of investment managers, which, Mr. Phillips said, could provide a disincentive for corporations to set up the pension funds.

While Mr. Bartolome expects the Spanish market to grow to accommodate some of the new pension assets, what institutional money there is hasn't been willing to fill the supply.

An analysis done for Kemper-Murray Johnstone International Inc., Glasgow, Scotland, showed that in 1988, estimated demand by domestic institutions was $4 billion, less than half of the available supply. That institutional de-

Italians explore stocks

Expedited settlement draws interest of foreigners

By Pete Retzbach

MILAN, Italy — Despite a few storm clouds on the horizon, things are looking good for Italian institutional investors.

Like most of their counterparts in Europe, Italian investors are slowly moving from the conservative, traditional investments in government bonds and real estate and turning to the stock market.

According to data from Arnhold & S. Bleichroeder Inc., New York, the Milan Stock Exchange rose 21.9% in 1988 in local currency terms, with a market capitalization of $132 billion.

Italian institutional investors — which include big commercial banks, insurance companies and the mutual fund industry — seem increasingly attracted to the stock market.

Foreign investors also are looking at the Italian stock market with more interest. A big reason is the implementation of an electronic trade settlement system. In the early 1980s, investors wanting to put assets into Italy were hampered by horrendous trade settlement problems that took weeks and often months to clear.

Malcolm Duncan, a consultant with the Milan Stock Exchange, said establishment of the electronic settlement system — called Monte Titoli, which literally translated means mountain of securities — solved the settlement problem for foreign investors. "Some of the problems that plagued the (Milan) market are a thing of the past."

One remaining problem with the Italian stock market is the huge share — as much as 50% — held by the families that own the large Italian conglomerates, said Alessandro Valeri, head of institutional sales at Sige, the largest brokerage in Italy. These families tend to hold the majority of Italian blue-chip stocks, and they and the companies they control tend to trade the stocks back and forth, giving other investors practically no chance to own a piece of Italy's premier businesses, Mr. Valeri added.

Foreign investors do tap the Italian stock market, although not as much as other countries. "There is a constant presence of foreign investors in the Italian market," said Mr. Valeri. Foreign investors hold between $5 billion and $10 billion in Italian stocks depending on stock rotation. "Foreigners tend to buy and sell much more quickly" than the Italian investor, Mr. Valeri said.

Another big player in the Italian institutional market — the mutual fund industry — is having a harder time. Although raising its percentage in the stock market, the industry is being hurt by a flood of redemptions that started after the market debacle of October 1987.

Giovanni Zocche, an officer with the New York branch of Banca Commerciale Italiana, the second-largest bank in Italy, said mutual fund assets — managed mostly by subsidiaries of the Italian banks — dropped 13% in 1988 to about $38 billion. Mutual funds were 6.1% of the gross national product in 1988, 1.1 percentage points less than in 1987.

Mutual funds are increasing their percentage in the stock market at the expense of bonds. Mr. Zocche said mutual funds in 1988 had about 27% of their assets in the stock market and 52% in government bonds. In 1989, the bank predicts mutual funds will invest 3.6 percentage points more in the stock market and 3 percentage points less in government securities. The balance is invested in cash and foreign markets.

The infant pension industry is another story. "There is a boom in the pension fund industry," said Giovanni Palladino, head of research for the Fideuram Group, Rome, which runs life insurance and mutual products for Italian investors.

Mr. Palladino said the pension fund industry is being encouraged by the government to take some of the load off the overtaxed Istituto Nazionale della Previdenzia Sociale, the equivalent of the U.S. Social Security system.

The government is encouraging the private pension system, estimated to be about $80 billion, because of the aging of the population and the problems of the Italian state-run system — Mr. Duncan of the Milan exchange termed the state system as "going bust." Only a few companies are establishing pension funds for their employees so far. Most of these pension assets are managed by the Italian life insurance companies, which keep their investments conservative, mostly in bonds and real estate.

The Italians also are preparing for investing more in other countries, though the only activity right now is in the European bond arena, mostly German bonds. ■

Spanish market

Continued from page 20

mand is estimated to drop to $3.3 billion in 1989 and $3 billion in 1990, according to James Smith, investment officer for Kemper-Murray.

According to a Salomon Brothers Inc. publication, after three years of substantial capital restructuring of Spanish industry, companies are less likely to need further equity financing. Therefore, the growth in new equity supply should ease, whereas demand for equity will benefit from the gradual return of foreign investors — who had been net sellers in 1988 — and a higher weighting of equity in domestic investors' portfolios.

Ms. Franklin said the amount of Spanish investments in international markets is "minimal" because the Spanish economy is in the midst of much-needed restructuring. "There is very little interest in investing overseas," she said. "It is a tough sell to get Spanish investors to look internationally."

Another important factor relating to the Spanish markets is a government decision allowing banks to broker in mutual funds, according to Enrique Catalan, an associate with Salomon Brothers, New York.

He said the country's eight biggest banks account for 33.76% of the Madrid Stock Exchange Index.

The Salomon publication said Spanish commercial banks are arousing foreign interest for joint

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A nervous Switzerland

Unease over 1992 making banks a bit fidgety

By John Parry

GENEVA, Switzerland — Despite a brave face, there is some unease in Switzerland over the potential impact of the adoption of a single market by the Common Market countries in 1992.

Although the details have not been worked out yet, the establishment of the single market will, in theory, allow cross-border banking within the European Community. Switzerland is not a member of that community. Although the major banks profess not to be worried by its advent — "I think we all have such heavy presences in London, Frankfurt and the other EC cities that we can take the blow," said Andrew Large, vice president of Swiss Bank Corp., the nation's second largest — there is some unease over the long-term investment future.

The bulk of Switzerland's trade is with the European Community; if the doors are closed — or open only a crack — after 1992, there would be a serious problem for investors sitting on vast piles of money with little to do with it.

In addition, the Swiss franc also has been falling against the dollar — not significantly, but enough to cause a twinge of uneasiness. The robust Swiss economy and the continuing vast inflows of foreign money will prevent significant depreciation, according to the prevailing wisdom here, but the Swiss National Bank has raised its rates to stabilize the franc and reinforce its commitment to a tighter monetary policy.

All these events have combined to reinforce the traditional conservatism of Swiss institutional investors. Already burned by the events of 1987's Black Monday, the past year has made them even more cautious of putting their money anywhere except in real estate and the rock-solid bond market.

Inflation has something to do with it. "There has been a fundamental change in the attitude of Swiss banks to inflation, and this is reflected in the institutional market," said Peter Buomberger, chief economist of Union Bank of Switzerland. "And then there's 1992 of course."

According to Serge Camilleri, manager of the Swiss branch of William M. Mercer, the U.S. actuarial and benefits consulting firm, these threatened reverses are going to keep institutional money in domestic markets, reinforcing the trend of the past two years.

Commenting on figures from the United Nations that show the U.S. domestic economy growing more slowly than expected, Mr. Camilleri said it is clear Swiss investors believe they are better off at home.

Smaller Swiss pension funds have been boosting their interest in real estate. But fears the market would become over-saturated have not yet materialized, according to Walter Dettwyler, a real estate consultant in Geneva. Mr. Dettwyler, who has been advising pension funds on real estate investments for many years, thinks the funds will continue to stay in real estate simply because there isn't anywhere else to go.

"They got burned by moving into the stock market just before 'Black Monday' and it takes a long while to forget a moment like that," he said. "It's true the real estate market is relatively small . . . but at least it's a good sound investment. It's one of our national characteristics that we like to see our money in bricks and mortar."

The pension funds also have been thwarted in their efforts to buy more into industry by rule changes at some major companies that effectively bar holding more than 2% of a company's registered shares. These changes were pushed through last year by CIBA-GEIGY and Sandoz AG, two major pharmaceutical and chemical multinationals based in Basle.

Other companies were expected to follow suit. Indeed, when Nestle S.A., long known as one of the most tightly held Swiss companies, suddenly allowed foreign investors to purchase its registered shares on the open market, it implemented a 3% holding limit on the registered shares.

Previously, foreign investors could only purchase Nestle bearer shares (*Pensions & Investment Age*, Dec. 12). The result of opening the registered shares to foreigners was a substantial boost in the price of the shares and a tumble for the bearer shares, which had traded at a 100% premium.

Foreign investors were expected to rush into the registered market but were held back by the 3% rule.

In addition, this has not been a very good year for Swiss banks.

A series of embarrassing scandals — many of them touching Credit Suisse, the nation's third largest bank — has produced an unaccustomed flurry of investigative reporting by the press, which has turned up a seemingly casual attitude toward money laundering from foreign drug smuggling and other dubious activities.

Credit Suisse has had its wrist slapped by the Swiss Banking Commission for being too casual.

The banks themselves have lost millions in the shakedown process of their London operations during 1987 — and the banking commission ruled the banks no longer conceal these losses in the "hidden reserves," which traditionally were not included in the annual reports. ■

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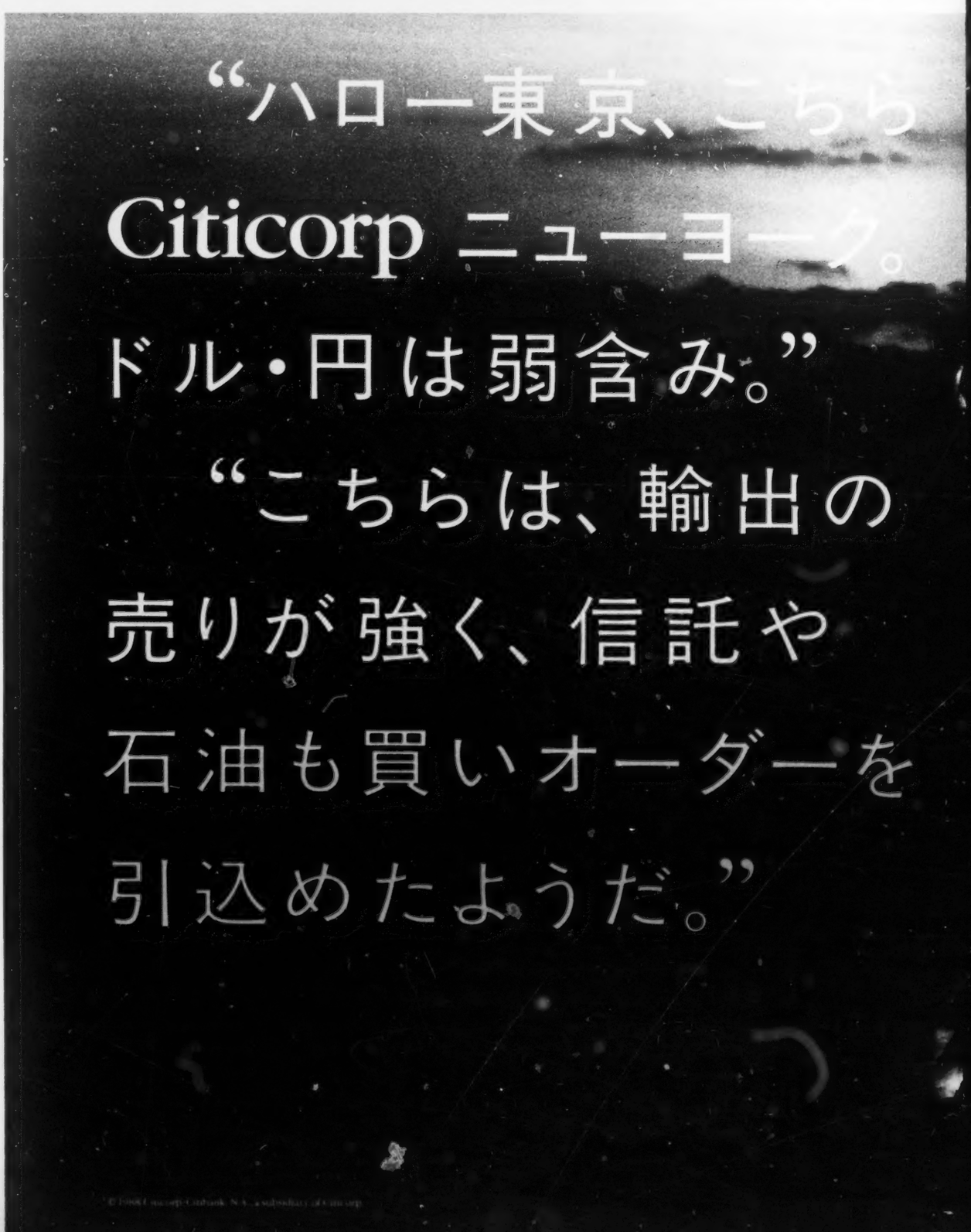


Australia tax

Continued from page 15

that had not yet become law. "We're being governed by press releases instead of legislation," he said.

Caution following the crash also has meant moving away from equity managers to the larger balanced managers such as Bankers Trust Australia, National Mutual, Westpac Banking Corp., and AMP Society.

Mr. Stevenson said manager performance, which had been a major issue for pension fund trustees after the crash, would probably become an issue again because of continued poor performance during the past six months.

"The surveys are showing that most managers are averaging only about 2% or 3% returns while you can get 18% on the money market," he said. "Some managers have just kept losing after the crash."

He noted the "flight to quality stocks" had been caused by the crash and entrenched by the 15% tax on investment earnings.

The best performing managers in the past year — mostly balanced managers — also have been attracting an increased share of available new business.

Pension funds have lifted their holdings of cash and other fixed interest securities, increased their equity exposure (after seeing this reduced sharply during the crash aftermath) and reduced their property exposure.

According to TPF&C, one of the largest actuarial firms in Australia, for the year ended Sept. 30 — the latest figures available — pension funds increased allocations to fixed income (to 22% from 16% a year earlier) and cash and miscellaneous investments (to 20% from 10%). Funds decreased allocations to domestic stocks (to 35% from 47%) and overseas investments (to 13% from 17%). Real estate was unchanged at 10%.

Offshore investments have been generally steady in absolute terms but have been increased in terms of their share of equities exposure. There also has been a noticeable increase in the use of futures and options as hedging instruments.

The complexities of administering pension funds have been further compounded during the past year by the introduction of operating procedures for the government's newly formed Insurance and Superannuation Commission.

The ISC required pension funds to register themselves, be audited and issue annual reports to members. According to David Solomon, vice president of TPF&C, some of the larger funds — which already had regular audits and professionally prepared annual reports — were not greatly affected. But for others, the regulation meant additional work and costs.

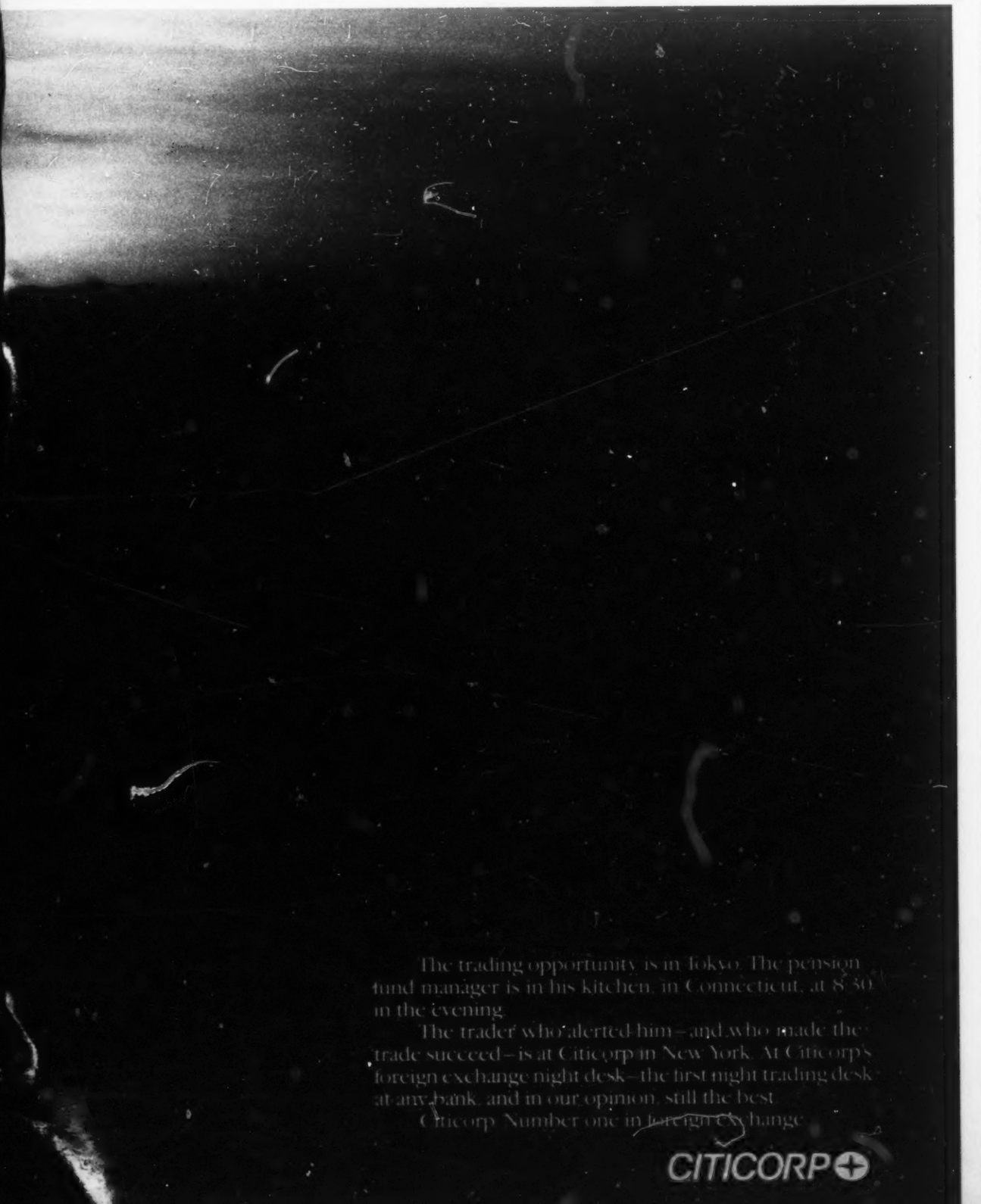
Mr. Solomon said the changes have added 20% to 30% to the cost of administering a medium to large pension fund. There also is a noticeable trend for in-house funds to turn to outside consultants or to use one of the life insurance company administration services.

"There also seems to be a move away from some of the smaller consulting firms to the larger ones who have more resources to cope with the complexities," Mr. Solomon said.

The pension fund changes have been a boon to consultants who have had difficulty coping with the extra workload in the past 12 months.

Business has been booming for for the consulting actuaries, Mr. Stevenson said. Administrative charges recently were increased 25%, largely to cover increased costs associated with the new rules and regulations.

As a sign of the growth in the consulting business, Mercer now employees about 330 people, he said, compared with 147 in 1986. ■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Private plans can fill need

BRIGHTON, England — There is room in most European Community countries for private pension systems to supplement the government social security systems, but not now in Spain, Italy and Portugal, according to a top British pension consultant.

John Martin, senior partner of R. Watson & Sons, Reigate, told pension executives at the International Business Communications conference on Pensions and Employee Benefits in Europe, that government pension systems provided retirement benefits equal to between 80% and 90% of national average earnings in those three countries.

This leaves little room for private pension systems, except for highly paid executives. He said, however, those government benefit levels were likely to be unsustainable during the long term.

In the other EC countries — where government pension benefit levels range from 20% of national average earnings in Denmark to 60% in Belgium — there is room for supplemental pension plans.

The structure of these supplementary plans varies from country to country, with Denmark having the most flexible structure and France the most rigid.

In addition, some countries, particularly the United Kingdom and the Netherlands, provide for a third level of benefits, generally in the form of tax incentives, to encourage personal pension plans, Mr. Martin said. This third level is unlikely to provide more than 10% of pre-retirement income.

Mr. Martin noted that while all state systems are pay-as-you-go, there is a great variety of financing methods for the supplemental systems — ranging from pay-as-you-go in France to book reserving in Germany to funded plans in Denmark and the United Kingdom.

While the arrival of the single internal market in the EEC Dec. 31, 1992, might cause the alignment of some benefit provisions, it is unlikely to cause dramatic changes in differences in benefits or funding methods, Mr. Martin said.

"Before real harmonization (of benefits) can occur . . . there will have to be some harmonization of taxation, not only as regards the benefits . . . but also personal and company taxation," he said. ■

U.K. funds do well in '88

EDINBURGH, Scotland — In 1988, the U.K. pension industry "met with a high level of investment success," especially the larger funds, according to a study by The WM Co.

The 1,444-fund universe of the consulting firm posted a weighted average total return of 13.8%, including property, and 12.1%, excluding property. The median return was 11.6%.

Larger funds, however — those with more than about $1.7 billion — returned 15% last year, including property, while smaller funds — those with $25 million or less — returned around 11.5%, according the WM report.

Apparently, larger funds got a big boost from the property sector, which rose 32.8%. According to the report, "the large funds still maintain substantial property portfolios, up to 15% (of total assets) which will have made a significant contribution in real terms."

In comparison, the smaller funds had an average allocation to property of 3%.

In general last year, it appears the larger funds "were holding their ground, and reaping the rewards in the form of the highest investment returns. The smaller funds overreacted to the 1987 crash, rushing out of falling markets and often missing the boat when the recovery began," according to the analysis.

WM points out that "against a backdrop of disinvestment at the end of 1987, overseas equities bounced back in '88 with a return of 23.4%, with 21% of this coming through in the first six months."

At year-end 1986, large funds had an average allocation of 17% to overseas equities. That dropped to 13% at year-end 1987, rising slightly to 15% by year-end '88. Small funds, for the respective periods, had average allocations of 25%, 17% and 18%.

Among WM's other findings:

- At the end of 1987, many funds took profits from their overseas holdings, even though their income stream from those stocks remained unaffected.
- After the 1987 stock market crash many funds, particularly smaller ones, rushed into cash, meaning they would have "missed out on market rises as suggested above."

The WM Co. billed the U.K. pension fund industry as "the most successful" in the world. "The competitive pressures within the industry have led U.K. funds to hold the highest proportion of real assets during the last 20 years — a period of particularly strong performance by real assets."

The consulting firm's report added "this has meant that U.K. pension funds have produced the highest real returns compared with other countries."

For instance, U.K. pension funds have 83% invested in real assets, compared with 50% for the United States and 10% to 20% for Japan. The average fund has posted a 14.7% per annum return during the past five years, and 17% for the past 10 years. These figures represent real returns of 9% and 10% per year for the respective periods. That, said WM, is "well above conventional actuarial assumptions." ■

Japanese

Continued from page 15

tremendous confidence in the market," he said. He expects the changes will allow companies to maintain a steady, if not an increasing, stream of earnings.

That confidence should even overwhelm the current Recruit Cosmos Co. scandal, according to Peter Green, president of James Capel Inc., London. The chairman of Recruit Cosmos and the former chairman of Nippon Telegraph and Telephone, the largest Japanese company, have been indicted on bribery charges in connection with the issuance of stock before sale. Though Japanese political leadership has also been implicated, which could lead to a change in government, Mr. Green thinks the scandal "is standard form in Japan" and will not affect the market.

"Westerners have always misunderstood the Japanese market," he said.

Daiwa investors, however, "are advised to monitor carefully."

While Daiwa expects individuals to assume a greater role in the Japanese market, they also expect that institutional investors will add to their significant role. Between 1984 and 1988, the share of market trading value held by the institutions had grown to 54.8% from 24.8%, while during that same time, individual participation had fallen to 32.3% from 54.3%.

The institutional presence in the Japanese market has its cost, according to Daiwa. Volatility, as measured in the proportion of yearly lows/highs was just 19.31% in 1984; after dropping to 13.72% in 1985, it jumped in the next three years to 47%, 43.70% and 42.15%, respectively, the years that institutional participation in the Japanese market rose 121%.

"Increased participation by institutional investors full of liquidity resulted in this increased volatility, in our opinion," Daiwa's report states.

While institutions are playing a major role in the Japanese markets, they also play an important role in foreign markets.

Japanese investors have been the leading international investors worldwide the last three years and should continue to do so, according to Bob Johnson, executive director of the International Real Estate Institute, Scottsdale, Ariz., which has offices in 98 countries and recently published a study of Japanese investments in the U.S. in 1988.

Mr. Johnson said Japanese were net purchasers of $11.2 billion worth of U.S. securities in February. According to Daiwa, Japanese were net buyers of foreign stocks in ten out of the 12 months of 1988, topping the year with nearly $1 billion in net purchases in July.

Bonds were a similar story. The low month for Japanese investment, like the yearly low for stocks, was in March, and its high point, at about $13.5 billion in net purchases, was in July.

Yakuda's Mr. Ira, however, said the Japanese increasingly are looking outside the United States for foreign investment for diversification purposes and because of they think U.S. market returns will sag.

While Yakuda has between 80% and 90% of its $4 billion foreign portfolio in the United States, it projects that in three to four years it will drop to between 50% and 60%. "There doesn't seem to be sense in increasing allocations in a market that isn't expected to go up," Mr. Ira said.

He said the expected change to

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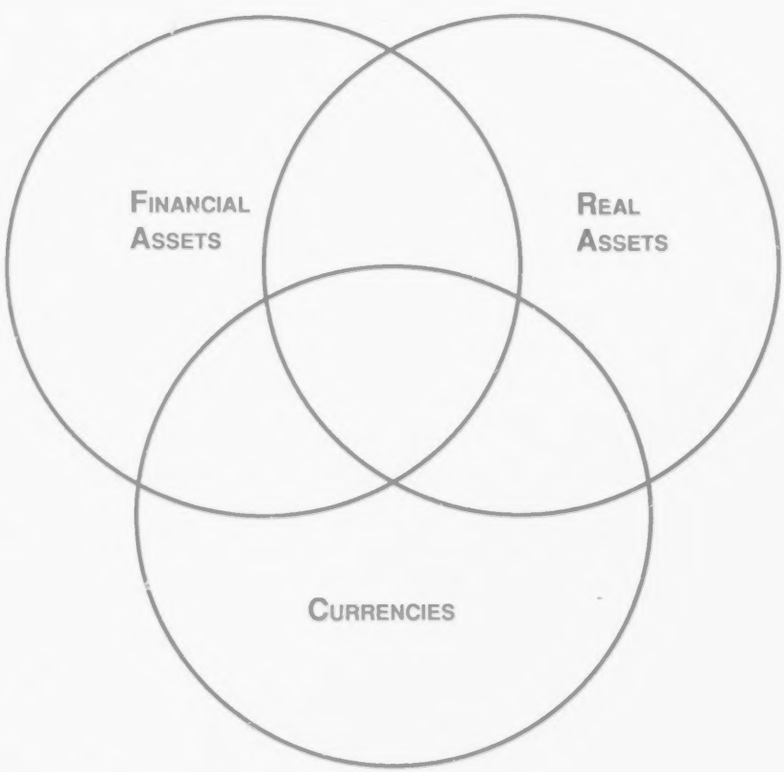

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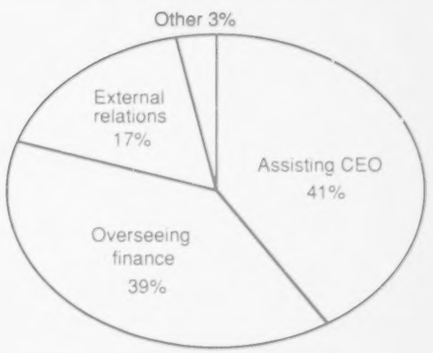
FINANCING

Modern CFO's role has new look

How the CFO allocates his time



Source: Business International Corp. and KPMG Peat Marwick

By Marlene Givant Star

NEW YORK — Corporate restructuring, the globalization of financial and product markets and the increasing complexity of financial markets are profoundly expanding the role of corporate chief financial officers.

These days, a chief financial officer's top priority is to help set the company's direction through strategic planning, capital budgeting and asset allocation. He or she needs to develop a keen understanding of operations by interacting closely with managers of operating units and spending more time with the chief executive officer.

These are among the findings of a study by Business International Corp., New York, and KPMG Peat Marwick, New York, on the expanding role of the financial officer in multinational corporations. They surveyed 235 financial officers and provided the details of the extensive study exclusively to *Pensions & Investment Age*.

Nearly seven out of 10 respondents have seen their influence over operating decisions increase in recent years and more than 50% are working more closely with the chief executive officer in charting corporate strategies.

At 36% of the multinational companies surveyed, the financial officer has been elevated formally in the corporate hierarchy and almost half of those surveyed now are on their company's board of directors.

The rise in rank has been especially pronounced in European and Asian firms where more than 60% are board members vs. only 37% in North American companies.

The supervision of the finance function has become secondary to assisting other senior executives with operating management issues.

Recent changes in corporate structure, the new emphasis on profit centers and the sophistication of financial markets are altering the organization of the finance function of corporations.

Now, although finance is centralized at most companies, there is a trend toward decentralization when the function becomes more integrated with operations; more companies view finance as a profit center; and to boost profits, companies are maximizing the internal use of funds while minimizing tax liabilities. Senior financial executives are actively managing risks and costs with options, swaps and overseas markets, and chief financial officers are taking steps to reduce the risk of speculation and fraud by tight-

Continued on page 34

New bank ties coming slowly

NEW YORK — Despite the inroads made by commercial banks into investment banking, chief financial officers still look to them primarily for traditional lending, according to a study by Business International Corp., New York, and KPMG Peat Marwick, New York.

Corporations are increasing their banking relationships, partly in order to diversify their exposure to bank risk from less developed country loans, the U.S. savings and loan crisis, foreign exchange and bond trading losses and concerns about capital reserves. These additional relationships also are allowing foreign institutions to gain a foothold.

Although still strong, the relative importance of bank lending to corporations will decline during the next few years. In turn, the significance of the functions of structuring complex financial arrangements, providing information and financial advice and leading corporations into the worldwide financial markets will grow, according to the study, which surveyed 235 chief financial officers.

Some companies already are taking that view. Eastman Kodak Co., Rochester, N.Y., sees its banks primarily as executors of capital and money market transactions rather than as credit providers. "We expect commercial and investment banks to be partners, not just providers of such services," Tom Rogers, director of cash management, said in the study.

Chief financial officers favor international banking trends that create a less regulated, more competitive financial services industry. They view positively the emergence of niche banking, the move toward commercial banks offering investment banking services, the shift toward fee-based services and bank mergers and acquisitions.

In addition to these findings, the study documented a number of changes in corporations' relationships with their financial service providers:

- Corporations are increasing the number of banks with which they do business. Companies are using more banks for cash management, foreign exchange trading and deposits.
- Despite the trend toward companies obtaining funds directly from investors at less cost than bank financing, companies still tend to use investment banks for debt and equity placements, mergers and acquisitions and restructuring. They turn to commercial banks for cash management, foreign exchange trading and deposits.
- The most important selection criteria for commercial banks are efficiency and quality of services, competitive pricing and responsiveness. For investment banks, responsiveness is first followed by innovation and efficiency.
- Companies still see the key role of banks to be ensuring the availability of funds, facilitating trade and providing depository services.
- Although the chief financial officers almost unanimously support the concept of relationship banking, they don't believe strong relationships must be at the expense of competitive pricing. Rather, they expect the personal service of traditional relations to be coupled with the competitive pricing and high-quality services of transaction-oriented banking.

When companies change banks, financial executives are motivated by either the need to use their in-house finance staff more effectively by focusing on a smaller number of financial institutions or the need to obtain the best possible expertise and assistance in coping with complex markets.

Corporations are more likely to increase the number of their foreign banks than their domestic ones, largely because of an expanding international presence and the increased international profile of European and Japanese banks. ■

Marlene Givant Star

Expanding duties pull financial executives up the salary ladder

Revenue of $10 billion or more

Company	Top financial officer / salary / other compensation	Chief executive / salary / other compensation
Amoco	J.W. Cozad / $550,307 / $450,000	R.M. Morrow / $777,540 / $500,000
Atlantic Richfield	Ronald Arnault / $843,222	Lodwrick Cook / $1,633,529
Bell Atlantic	Philip Campbell / $384,000	Thomas Bolger / $694,500
Boeing	H.W. Haynes / $617,855	Frank Shrontz / $846,323
Chrysler	R.S. Miller / $444,951	Lee Iacocca / $865,673
CIGNA	James S. Stewart / $791,000	Robert D. Kilpatrick / $1,587,000
Dow Chemical	Enrique Falla / $484,279	Frank Popoff / $1,039,539
Goodyear	Oren Shaffer / $291,000 / $161,255	Robert Mercer / $900,000 / $379,345
IBM	F.A. Metz / $689,513	J.F. Akers / $1,525,500
ITT	M. Cabell Woodward Jr. / $1,034,484	Rand Araskog / $2,233,974
Lockheed	V.N. Maragino / $676,904	L.O. Kitchen / $1,145,746
Mobil	James Q. Riordan / $987,833	Allen Murray / $1,609,044
PepsiCo	Robert G. Dettmer / $572,459	D. Wayne Calloway / $1,364,688
Philip Morris	Hans Storr / $355,000 / $318,499	Hamish Maxwell / $762,500 / $897,727
United Technologies	John Rolls / $347,291 / $220,000	Robert Daniell / $697,916 / $450,000
USX	W. Bruce Thomas / $522,895 / $375,000	David Roderick / $961,028 / $1,000,000

Revenue of $1 billion to $10 billion

Aluminum Co. of America	James Wirth / $462,668	Paul O'Neill / $1,112,876
American Brands	Arnold Henson / $535,000 / $150,000	William Alley / $1,025,692 / $325,692
Armco	W.B. Askins / $414,707	R.E. Boni / $678,404
Ashland Oil	Paul Chellgren / $301,081 / $217,545	John Hall / $611,554 / $386,298
Bethlehem Steel	Gary Millenbrach / $262,500	Walter Williams / $505,000
Capital Cities/ABC	Ronald Doerfler / $673,200	Thomas Murphy / $907,000
Carter Hawley Hale	John M. Gailys / $445,008	Philip Hawley / $665,004
CBI Industries	G.L. Schueppert / $233,061	W.A. Pogue / $470,903
Centel	Eugene Irminger / $262,500	John Frazee / $638,750
Columbia Gas	Robert A. Oswald / $210,700	John H. Croom / $500,000
Control Data	John Buckner / $325,800	Robert Price / $862,100
Dun & Bradstreet	Richard F. Schmidt / $459,923	Charles W. Moritz / $1,119,635
EG&G	John R. Dolan / $324,234	John M. Kucharski / $685,110
Enserch	S.R. Singer / $305,000	W.C. McCord / $650,000
Federal Paper Board	Quentin J. Kennedy / $333,439 / $394,850	John R. Kennedy / $817,112 / $965,210
Fluor	Robert L. Guyett / $337,380	David S. Tappan Jr. / $898,827
General Re	Ronald Anderson / $325,167	Ronald Ferguson / $979,351
Harcourt Brace Jovanovich	John Beradi / $301,712	William Jovanovich / $2,922,878
Hercules	Arden Engebretsen / $374,308	Fred Buckner / $419,945
Ingersoll-Rand	C.H. Folley / $712,950	T.H. Black / $787,617
Inland Steel	Theodore Myers / $365,000	Frank Luerssen / $940,000
Kerr-McGee	John Linehan / $186,963	F.A. McPherson / $420,773
Litton Industries	Joseph T. Casey / $655,332	Orion L. Hoch / $997,227
Lyondell Petrochemical*	Dan F. Smith / $312,317	Bob G. Gower / $677,568
Maytag	Jerry Schiller / $350,695	Daniel Krumm / $898,407
Merrill Lynch	Courtney Jones / $1,000,000	William Schreyer / $2,500,000
Pan Am	Richard Francis / $231,844	Thomas Plaskett / $494,000
Pennsylvania Power	C.E. Russoli / $192,517	R.K. Campbell / $356,804
Santa Fe Southern Pacific	Orval Adam / $302,750	Robert Krebs / $600,000
Schlumberger	A. Lindenauer / $477,000	D.E. Baird / $1,025,000
Sherwin-Williams	T.R. Miklich / $254,404	J.G. Breen / $745,896
Squibb	Anthony Ruggiero / $575,000	Richard M. Furland / $1,541,676
Tyson Foods	Gerald Johnston / $204,078	Don Tyson / $2,568,262

Revenue of less than $1 billion

Cincinnati Bell	Dennis Sullivan / $400,433	Dwight Hibbard / $671,312
Fairchild Industries	Edward Murchie / $271,312	Emanuel Fthenakis / $663,390
Federal Mogul	R.W. Hague / $320,650	T.F. Russell / $1,002,247
Mattel Toys	Charles J. Lee / $349,771	John W. Amerman / $563,860
Newmont Mining	E.P. Fontaine / $352,070	G.R. Parker / $832,465

* for the three months the company has been public
Source: Proxy statements

Modern CFO

Continued from page 31

ening internal reporting and control systems.

As a result of their expanded role, financial officers increasingly are delegating their traditional tasks to treasurers and controllers. Chief financial officers now tend to be involved in transactions like mergers and acquisitions, corporate restructurings and equity placements, while other transactions like bond and money market issues tend to be handled by treasurers or assistant treasurers, according to David J.P. Meachin, managing director of Merrill Lynch investment banking, who was quoted in the study.

In a worldwide environment of mounting takeover pressures, many top financial executives continually reassess operating units to ensure their value is fully realized.

"Corporate management must ensure that its company is worth as much whole as it would be if disassembled by a raider," D.R. Kayser, chief financial officer of Allied-Signal Inc., Morristown, N.J., said in the study.

In trying to protect the company's assets, the financial executive evaluates the quality of different types of financial products in relation to corporate strategies. For example, Olivetti, the Italian computer manufacturer, no longer is satisfied with the traditional treasury approach to hedging foreign exchange exposure. Instead, it focuses mostly on how the movement in foreign exchange rates will affect operations, according to Angelo Fornasari, vice president-finance.

Chief financial executives have full responsibility for management information systems/information management; shareholder relations and economic planning and forecasting. In addition, a majority of those surveyed have input into decisions in corporate development, strategic planning, investment/divestment strategies, mergers and acquisitions, corporate administration and government relations.

The study also highlighted a number of differences between the executives' responsibilities at U.S., all North American and foreign multinationals. For instance, treasurers of North American companies tend to have more direct responsibilities than their European and Asian counterparts, and financial planning staff members report directly to the chief financial officer more often in Asia and Europe than in the United States.

North American companies also place more emphasis on performance measurement than their European and Asian counterparts.

Reflecting the trend toward companies being managed on a worldwide basis, the corporate finance area has become highly centralized. Sixty percent of the companies have centralized the corporate finance function as opposed to just more than 20% that are decentralized. During the next few years, 25% of the respondents plan to centralize finance further.

Of the respondents, 81.2% are taking a more profit-oriented approach to finance than they did in the past. For some companies, that means positioning the treasury as a profit center with foreign exchange and borrowing/investing activities structured to generate income from both internal and third-party transactions. For others, a profit center orientation entails close cooperation between finance and operating units to meet explicit financial targets.

Innovative financial management is being used to boost the bottom line of corporations. Chief financial officers recognize internal funds are the cheapest source of capital because there are no risk premiums to be paid to lenders or investors and no dilution of equity and potentially restrictive bond covenants. When external funds are needed, the executives shop around for the best rates from the swelling ranks of international financial service providers. To lower the cost of external financing, the executive strives to improve his company's financial position or credit rating.

The respondents balance the management of assets and liabilities and each of those functions is a balancing act in itself. In managing liabilities, the executives recognize inadequate leverage decreases the tax shield for corporate earnings through underutilization of tax-deductible interest payments, the survey found. Too little leverage may also generate substantial free cash flows, which — if they are not distributed to shareholders — become excessive, leading to suboptimal investment decisions and complacency among operating units. This lowers the value of shares, breeds shareholder discontent and invites a takeover, according to the report. To manage assets, a company must have effective strategic planning and budgeting and an efficient performance from the operating units. ■

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Japanese 'shelf' filed

NEW YORK — American Express Co. has established a shelf registration that will allow it to issue $264 million in debt securities in Japan.

It is the first non-government-affiliated foreign corporation to obtain a Japanese shelf registration. The company began exploring the idea of a shelf registration last fall to gain a foothold in the wealthy Japanese marketplace and make its debt accessible to local investors (*Pensions & Investment Age*, Nov. 28).

The company currently is not preparing a specific debt offering in conjunction with the shelf registration. Its was filed with Japan's Ministry of Finance on March 31 and took effect April 8.

It is estimated that less than 10 American companies would be eligible to file a shelf registration now. The system, which became effective Oct. 1, allows issuers to sell bonds within a pre-set time period without prior approval from the Ministry of Finance. ■

Money movers is a section that details the appointments of money management firms for tax-exempt funds.

The money movers section appears in each issue of *Pensions & Investment Age*.

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PORTFOLIO MANAGEMENT

Timber analysis perplexing

By F. Christian Zinkhan

The lack of a recognized performance standard for timberland presents a lingering obstacle to analyzing the appropriateness of the investment in a portfolio.

As a result, looking at timberland in the context of modern portfolio theory has been inhibited; one is less confident analyzing timberland's performance in the context of a portfolio of a variety of assets.

By a number of measures, timberland returns vary considerably. As an investment in itself, timberland's returns, as shown in the table, go from attractive to unattractive, depending on the index, in contrast to some other asset classes, unadjusted for risk. In the 10 years ended 1987, the latest year for which data on all three timberland indexes is available, the Standard & Poor's 500 Stock Index returned a compound annual 15.3%; the Shearson Lehman Hutton Government/Corporate Bond Index, 10.3%; and the FRC Property Index, 12.9%.

But it is in the context of a portfolio, as a benefit of diversification across asset classes, that timberland analysis holds the most interest for institutional investors.

A recent study by Thomas G. Harris Jr., professor of industrial management, and Christopher E. DeForest, research coordinator, both in the School of Forest Resources of the University of Georgia, found less than 3% of pension funds surveyed own timberland. The study uncovered a variety of perceived disadvantages associated with timberland, including illiquidity, riskiness and lack of information about it as an investment. But perception may not be reality.

Illiquidity can be reduced, although not eliminated, by such arrangements as pooled funds.

Timberland's riskiness should be viewed in terms of a portfolio with other assets, not as an investment by itself. A portfolio perspective can minimize and perhaps transform the perceived volatility into a benefit.

According to a recent study by Southeastern Center for Forest Economics Research, Research Triangle Park, N.C., the addition of timberland to a portfolio of financial assets reduced volatility more than 40%. Even in a portfolio containing commercial real estate and farmland, the addition of timberland reduced volatility more than 20%, according to another unpublished study.

One of timberland's biggest informational deficiencies is the lack of a generally accepted index, such as S&P's for stocks and FRC's for commercial real estate.

Although several timberland indexes have been developed, their use primarily has been limited to the firms that prepare them. First Wachovia Investment Management, Atlanta, compiles the First Wachovia Timberland Index; Forest Investment Advisors, Atlanta, the Southern Timberland Index; and John Hancock Mutual Life Insurance Co., Boston, the John Hancock Timberland Index.

A well-recognized timberland index would enhance investor confidence in analyzing the investment and serve as the basis for furthering study in a portfolio context.

Following are potential applications of such a widely used index.

Gauging the market

What was the return on timberland last year? How is it doing now? What's the forecast for next year? A timberland index can ad-

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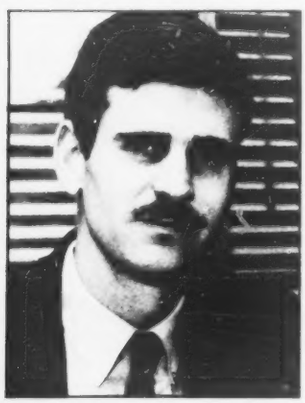


Mr. Zinkhan is chairman of the department of financial planning and accounting at Lundy-Fetterman School of Business, Campbell University, Buies Creek, N.C.

How well did timberland perform?

	Timberland Indexes			FRC
	First Wachovia	FIA	John Hancock	Index
1988	5.0%	NA	NA	1.7%
1987	16.4	11.9%	14.8%	5.3
1986	3.7	−0.2	−2.2	6.3
1985	−6.3	−10.8	−3.5	9.8
1984	11.2	4.1	−8.1	13.1
1983	15.1	16.9	−10.8	13.2
1982	16.0	0.1	−10.7	9.4
1981	18.2	18.1	5.4	16.8
1980	28.3	0.6	22.3	18.1
1979	7.7	15.6	34.4	20.7
1978	16.4	27.7	25.2	16.0
Compound annual return (1978 - '87)	12.3%	7.8%	5.6%	12.9%
Average standard deviation (1978 - '87)	9.4%	11.5%	16.4%	5.1%

The lack of a standard index for timberland investments makes it difficult for investors to analyze the asset class.

BOOK REVIEW

Author takes mystery out of GIC investments

By Fred Williams

For years, guaranteed investment contracts have been considered safe, sound and secure passive investments — but Kenneth L. Walker contends that idea should be reconsidered.

The GIC market has grown to nearly $150 billion, even though few outside the insurance industry have a clear picture of exactly how insurance companies issue and price these "safe" investment vehicles. The arcane world of the insurance business has been foreign, and to a large extent remains so.

But the GIC market has become a major factor in the defined contribution area; GICs are one of the most popular asset categories in participant-directed plans. About 30% of all assets in defined contribution plans are now invested in GICs.

The rush to GICs placed added emphasis on insurance company credit quality analysis, pricing mechanisms, contract negotiation, capacity problems and a host of other issues.

Mr. Walker, president of T. Rowe Price Guaranteed Asset Advisers Inc., Richmond, Va., and a nationally known expert in the field of GIC portfolio management, has drawn on his extensive background to shed some light on GICs and the insurance industry in his book, the first complete reference book on the investment contracts.

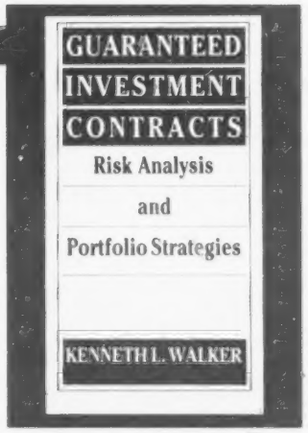
The need for such a work has been developing in tandem with the GIC marketplace. But this carefully done — yet less than exhaustive treatment — doesn't completely fill that need. The reader can't help but wish Mr. Walker had provided a more detailed and exact interpretation.

While the book covers a lot of material in very few pages, there are some areas that could have benefited from additional insight from an author with Mr. Walker's expertise. For instance, the section on credit quality of insurance carriers could have been expanded. (There are nearly 150 insurance companies nationally under liquidation or receivership.) The book contains 17 pages of general background information on the insurance industry and only six on GIC pricing by carriers.

As Mr. Walker notes in his chapter on defining GICs, "the use of GICs in 401(k) plans could be the subject of an entire chapter," and perhaps should have been.

But while this seminal work on GICs may leave you thirsting for more, it is a valuable addition to

Continued on page 48



Guaranteed Investment Contracts: Risk Analysis and Portfolio Strategies (Dow Jones-Irwin, Homewood, Ill.; 180 pages; $47.50)

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Timberland

Continued from page 47

dress these questions. Fundamental analysis, trend analysis and asset allocation obviously depend on an accurate index as a critical data source.

Modeling

The Capital Asset Pricing Model, among other asset pricing models, requires certain data to value risky assets. Without them, one cannot select investment alternatives, implement portfolio strategies and tactics or evaluate portfolio management performance. The CAPM focuses on market risk (that is, risk that can't be eliminated by diversification) and requires estimation of beta, a measure of an investment's market risk.

Using an existing timberland index, Southern Timberland, a recent study estimated timberland's beta to be −0.21.

One implication of a negative beta is the investment's required rate of return is less than the yield of Treasury bills, a risk-free return. As a result, the addition of an investment possessing a negative beta can reduce the risk of a diversified portfolio.

A well-recognized timberland index would enhance portfolio managers' confidence in estimating beta.

Benchmark

Did your timberland investment manager beat the timberland market last year? What return did timberland earn relative to stocks? Such questions cannot be answered confidently without a widely accepted index.

Similar to financial assets, the evaluation of timberland investment performance should include consideration of a relevant measure of risk.

Many timberland investment professionals agree a well-recognized timberland index is needed, but its design is not without controversy.

Three of the issues associated with the design of a stock index are the sample's components, their weighting and the method of calculating the average (geometric or arithmetic).

The design of a timberland index must address not only these issues, but also two others. Should the index be based on a hypothetical timberland fund or the performance of a sample of actual tracts? Should land value data be based on appraised values or prices from actual transactions?

Some academicians and at least one firm, Forest Investment Associates, developed hypothetical timberland funds to estimate historical timberland returns. These funds reflect timber growth models and are generally created with the assumption that forests are perfectly regulated so the total volume of standing timber remains constant over time. Perfect regulation results in an annual harvest equal to the annual growth. To generate a timberland index, a fund must also incorporate data on management expense, stumpage price, raw land value, property tax and forest management practice assumptions.

An option is to follow closely the methodology adopted by the Frank Russell Co., Tacoma, Wash., and the National Council of Real Estate Investment Fiduciaries, New York, in the FRC Property Index of commercial real estate. Cooperating timberland owners could supply net operating income and property values to the producer of the index.

But accuracy comes at a high cost, the price of assembling an index with a large number of transactions. A hypothetical fund, however, may sacrifice accuracy by using only a sampling of sales.

The second issue — whether to base the property value changes on appraisals or actual transactions — is also faced by the designers of commercial real estate indexes.

Although transactions-based data certainly provide accuracy, the volume and representativeness of such data can be limited.

Appraisals, on the other hand, offer an artificial perspective of real values, on a risk-adjusted basis. As academic literature has noted, appraisals unrealistically smooth actual volatility of returns. ■

Utility fan of equity

But keeps fixed-income for its trust

By Curtis Vosti

ROSEMEAD, Calif. — Southern California Edison Co. presents an interesting study of the fledgling nuclear decommissioning trust industry.

Although it is part of an industry push to allow equities in tax-qualifying trusts, the Los Angeles-area utility so far has declined to use equities for its non-qualified trusts, in which equity investments are allowed.

Also, the proposed merger with San Diego Gas & Electric Co., if successful, would necessitate the decommissioning trusts of the two utilities to be combined, the first time that issue will be faced by the nascent industry.

Nuclear decommissioning trusts are being established to pay for the decontamination and demolition of nuclear facilities at the end of their useful lives, about 40 years. The establishment of these trusts, which must be in place by June 30, 1990, has been the subject of actions by Congress, the Internal Revenue Service, the Nuclear Regulatory Commission and other federal and state agencies.

SoCal Edison has ownership interests in six nuclear plants.

In 1986, the IRS ruled that contributions made after 1984 to trusts for new facilities could be tax deductible if invested in so-called Black Lung investments, which include federal, state or municipal bonds and certain bank or credit union certificates of deposit.

For utilities with nuclear plants on line before 1984, only a percentage of future contributions -- representing the plant's useful life after 1984 — would be deductible. The portion of the trust representing the part of the plant's useful life before 1984, as well as any contributions before 1984, is not qualified, and can be invested in equities.

State utility commissions, however, have the power to set their own regulations and the California Public Utilities Commission allows only up to 60% of the non-qualifying trusts to be invested in equities.

The attraction of equity investments for nuclear trusts has been touted by consultants, money managers and industry officials, who are pushing to change federal law to allow equities in qualified trusts. It is argued that equities' higher real rate of return would help cushion the industry against future escalations in costs that could make current decommissioning estimates obsolete, and could lessen considerably the contributions needed, which are paid by utility ratepayers.

Members of SoCal Edison's nuclear trust investment committee are on the utility task force seeking the changes.

Despite the government allowances and its committee's activism, SoCal Edison chose to omit equity investments when it set up two non-qualifying trusts in February 1988.

Uneasiness about the equity markets in the wake of the 1987 market crash led to the decision, according to Doug Ertel, financial analyst. Non-qualified contributions to SoCal Edison's trusts comprise about 13% of the utility's contributions, about $1.04 million out of $8.09 million monthly, Mr. Ertel said.

Equity investment is "just something that hasn't happened yet. Last year, a lot of people were concerned about the equity market," Mr. Ertel said.

He's sure, however, the matter of equity investments will come up when the utility's investment advisory committee meets in May.

"It's a difference of a policy decision vs. a strategic decision," Mr. Ertel said. "This was not a policy decision. It was more of a strategic decision at the time. Bonds were relatively more attractive."

Bonds also are attractive to qualified trusts. A 1988 survey by National Investment Services of America, Milwaukee, showed even if the Black Lung restrictions on qualified trusts were removed, most utilities' would maintain their reliance on tax-exempt bonds.

The proposed merger with San Diego Gas & Electric is another matter.

If the merger is approved — and it faces opposition from a high-profile citizens group — the nuclear decommissioning trusts would be combined.

That potentially tricky problem would be eased somewhat by SoCal Edison's ownership share in all three of San Diego Gas & Electric's nuclear plants. The utilities used the same costs estimates in its funding studies, and also have the same trustee, Harris Trust and Savings Bank of Chicago.

"The bigger problem is the oversight committees are going to have to be merged," said Walter Kowalczyk, vice president of Harris Trust.

Nancy Ross, supervisor of financing and investment for the San Diego utility, said the combination of the two nuclear trusts could be sticky when it comes to the area of investment managers and policy. San Diego Gas & Electric now has only one manager, while SoCal Edison has two.

GIC mystery

Continued from page 47

financial publishing. Nowhere else can investors find a ready source of information on emerging techniques for active GIC management. Here financial executives will find a straightforward explanation of the benefits and risks of using GICs to invest retirement plan assets and a source of useful information on achieving optimal returns on GIC portfolios.

The two chapters on risks to GIC buyers and issuers as well as interest crediting and managing a GIC portfolio alone make the book worthwhile.

The theme throughout the book is that GICs are a fixed-income alternative and should be treated as any other fixed-income instrument. He also discusses insurance company statutory accounting and regulatory issues, issues sometimes overlooked by GIC buyers.

"Statutory accounting differs significantly from generally accepted accounting principles and produces an entirely different picture of the financial status of the company," said Mr. Walker. "Statutory accounting produces a distortion of the true net worth of the insurer. The assets of the company do not reflect the true market value. Bonds, for example, are reported at amortized cost value. Should the company ever be forced to liquidate all or a part of these assets, the liquidation value could be much different from the value the company carried on its books."

The purpose of statutory accounting is to show the degree of solvency of a carrier. Many assets are shown below market value or are excluded entirely. For example, prepaid expenses are not considered valid assets.

The insurance industry, as Mr. Walker points out, is in the liability management business. Each contract or policy it writes must be managed so as not to jeopardize the company's net worth, giving rise to a spectrum of investment and interest rate management strategies.

Some insurers deliberately mismatch interest rate risks with credit risks in order to generate higher gross investment rates.

"The greater the duration mismatch, the greater the gamble . . . This does not mean the insurer must have enough net worth to survive a losing bet. If the insurance company does not have sufficient resources, there is a residual probability . . . that the plan sponsor will have to provide the needed funds," said Mr. Walker.

The book contains many illustrative tables and graphs to make the text more meaningful. There is a sample contract along with verbatim wording from the Securities and Exchange Commission's exemptive letter on GICs and Rule 151, which represents the SEC's clarification of the status of certain annuity and life insurance products, along with historical data on GIC rates dating from 1982.

For GIC buyers, the chapter on contractual issues could well prove to be the most important in the book.

He provides a surprising revelation that "there is a lack of uniformity among the insurance companies in contractual issues. There is often a lack of uniformity within the same insurance company with any particular contract's terms depending on the amount of deposit, frequency of withdrawals, and type of client."

He offers a detailed review of a typical contract and a seven-point plan for negotiating a contract.

In his conclusion, Mr. Walker states the reader should have a better understanding of GICs — and that is certainly true.

Most financial texts treat GICs superficially at best, or offer academic or self-serving approaches to guaranteed products. This book is essential reading for those who already invest in GICs and certainly for anyone contemplating a GIC purchase.

It will not make one an instant GIC portfolio manager, but provides for the first time in one volume the best source for a better understanding of an asset category of growing importance to the employee benefits industry. ■

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STATISTICALLY SPEAKING

Narrow spreads continue for GICs

By Fred Williams

Yields on insurance company guaranteed investment contracts moved into double digits during the first quarter, while quality spreads over Treasury instruments continued to narrow.

"You could buy contracts 25 to 30 basis points over Treasuries in the first quarter, whereas at the end of the year spreads were about 50 basis points. Even though rates increased, they didn't increase as much as comparable Treasuries and corporates," said Tom Marthaler, portfolio manager at CTT Investment Management Group, Chicago.

The narrowing of spreads has been an ongoing phenomenon for nearly a year and some analysts believe spreads have reached their narrowest point for some contracts.

"There was a point at which some companies were quoting rates lower than comparable Treasuries," said Mr. Marthaler. "People were giving serious consideration to other alternatives such as bank investment contracts."

BIC spreads in the three- to five-year maturity range were yielding 15 to 25 basis points more than GICs for comparable credit quality, he said.

John Knight, president of Lamberson Knight GIC Inc., a Short Hills, N.J., GIC brokerage, said: "We saw a large increase in cash flow to GICs, particularly in the three- to five-year area. Most of the short-term money, one to two years, went to BIC products."

Mr. Knight said the continued narrowing of spreads also took some pressure off the periodic capacity problems experienced by insurance carriers. "For the first time, there was no capacity problem. . . . When spreads are wider, there are capacity problems because insurance companies have more problems finding investments for these assets," he said.

Gary Mink, president of the Mink Organization, a Rochester, N.Y., GIC consultant and brokerage, said the high GIC yields probably will continue through July because of continued pressure on interest rates by the Federal Reserve Board.

"You don't want to wait until the year-end rush to buy GICs. Plan sponsors should buy their contracts by May or June. Anytime you can get 10% plus is a good time to buy," said Mr. Mink.

Insurance company rate quotations on representative five-year, single-deposit, simple-interest, $1 million GICs as of March 30 and Dec. 29, as provided by Lamberson Knight and GIC Inc., a Beaverton, Ore., GIC manager, are:

- Allstate Life Insurance Cos., Northbrook, Ill.: March 30, 9.63%; Dec. 29, no quote.
- American United Life Insurance Co., Indianapolis: 9.69%; 9.4%.
- Canada Life Assurance Co., Toronto: 9.91%; 9.43%.
- CNA Insurance Co., Chicago: 9.64%; 8.94%.
- Confederation Life Insurance Co., Atlanta: 9.95%; 9.47%.
- Connecticut Mutual Life Insurance Co., Hartford, Conn.: 9.7%; 9.5%.
- Continental Assurance Co., Chicago: 9.79%; 9.09%.
- Crown Life Insurance Co., Toronto: 9.99%; 9.25%.
- Great West Life Assurance Co., Denver: 9.59%; 9.08%.
- Executive Life Insurance Co., Los Angeles: 9.98%; no quote.
- Great West Life Assurance Co., Denver: 9.6%; 9.08%.
- Hartford Life Insurance Co., Hartford, Conn.: 9.89%; 9.39%.
- Home Life Insurance Co., New York: 9.68%; 9.59%.
- John Hancock Mutual Life Insurance Co., Boston: 9.79%; 9.59%.
- Life Insurance Co. of Georgia, Atlanta: 9.9%; 9.34%.
- Life Insurance Co. of Virginia, Richmond: 9.72%; 9.32%.
- Lincoln National Pension Insurance Co., Fort Wayne, Ind.: 9.93%; 9.36%.
- Massachusetts Mutual Life Insurance Co., Springfield: 9.85%; 9.14%.
- Minnesota Mutual Life Insurance Co., St. Paul: 9.99%; 9.68%.
- Mutual Benefit Life Insurance Co., Newark, N.J.: 9.8%; 9.37%.
- Mutual of New York, New York: 9.77%; 9.37%.
- New England Mutual Life Insurance Co., Boston: 9%; 9.21%.
- New York Life Insurance Co., New York: 9.9%; 9.2%.
- Northwestern National Life Insurance Co., Minneapolis: 9.92%; no quote.
- Ohio National Life Insurance Co., Cincinnati: 10%; 9.5%.
- Pacific Mutual Life Insurance Co., Newport Beach, Calif.: 9.24%; 8.9%.
- Pan American Life Insurance Co., New Orleans: 9.89%; 9.49%.
- Penn Mutual Life Insurance Co., Philadelphia: 10.02%; 9.57%.
- Phoenix Mutual Life Insurance Co., Hartford: 9.66%; 9.38%.
- Principal Mutual Life Insurance Co., Omaha, Neb.: 9.56%; no quote.
- Provident Mutual Life Insurance Co., Philadelphia: 9.76%; 9.41%.
- Provident National Assurance Co., Chattanooga, Tenn.: 9.51%; 8.54%.
- Southwestern Life Insurance Co., Dallas: 9.89%; 9.47%.
- State Mutual of America, Worchester, Mass.: 9.75%; 9.4%.
- Transamerica Life Insurance Co., Los Angeles: 9.99%; 9.19%.

William M. Mercer Meidinger Hansen Asset Planning, Chicago, surveys insurance companies for rate quotations and provided the following summary of various bullet GICs for March:

- Three-year, $1 million, compound: high, 10.05%; low, 8.685%; average, 9.627%.
- Three-year, $1 million, simple: high, 10.09%; low, 8.685%; average, 9.635%.
- Five-year, $1 million, compound: high, 10.12%; low, 9%; average, 9.73%.
- Five-year, $1 million, simple: high, 10.11%; low, 9%; average, 9.75%.
- Seven-year, $1 million, compound: high, 10.05%; low, 9%; average, 9.7%.
- Seven-year, $1 million, simple: high, 10.06%; low, 9%; average, 9.742%.
- Three-year, $5 million, compound: high, 10.17%; low, 8.887%; average, 9.727%.
- Three-year, $5 million, compound: high, 10.17%; low, 8.887%; average, 9.727%.
- Three-year, $5 million, simple: high, 10.17%; low, 8.88%; average, 9.72%.
- Five-year, $5 million, compound: high, 10.22%; low, 9%; average, 9.787%.
- Five-year, $5 million, simple: high, 10.22%; low, 9%; average, 9.8%.
- Seven-year, $5 million, compound: high, 10.13%; low, 9%; average, 9.746%.
- Seven-year, $5 million, simple: high, 10.09%; low, 9%; average, 9.79%.

Dietrich & Associates, a Blue Bell, Pa., GIC brokerage, provided the following rate spread data between a $1 million, five-year, simple-interest GIC and the average Treasury security of the same maturity during the first quarter:

Jan. 3: GIC, 9.6%; T-bill, 9.21%.
Feb. 1: GIC, 9.5%; T-bill, 8.98%.
March 1: GIC, 9.75%; T-bill, 9.37%.

Mercer Meidinger Hansen also surveys banks for rate quotations on guaranteed instruments. Rate quotations for one- and three-year bullet BICs for March were:

- One-year, $1 million, compound: high, 10.93%; low, 9.32%; average, 10.14%.
- One-year, $1 million, simple: high, 10.93%; low, 9.8%; average 10.27%.
- Three-year, $1 million, compound: high, 10.53%; low, 9.73%; average, 10.09%.
- Three-year, $1 million, simple: high, 10.53%; low, 9.34%; average, 10.134%.
- One-year, $5 million, compound: high, 10.95%; low, 9.32%; average, 10.14%.
- One-year, $5 million, compound: high, 10.95%; low, 9.68%; average, 10.291%.
- Three-year, $5 million, simple: high, 10.55%; low, 9.73%; average, 10.108%.
- Three-year, $5 million, compound: high, 10.55%; low, 9.86%; average, 10.227%. ■

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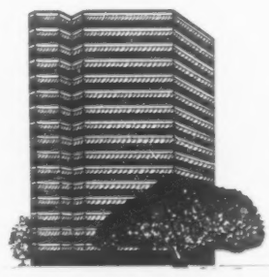

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Sector bounces back

By Trudy Ring

KANSAS CITY, Mo. — Stocks sensitive to interest rates were the best performers of the first quarter, while Yankee and foreign bonds led the fixed-income market, according to DeMarche Associates Inc.

Interest-sensitive stocks had a price gain of 8.4%, rebounding from being the worst-performing sector the previous quarter at −0.9%. The sector consists mainly of financial services companies and utilities.

The Standard & Poor's 500 Stock Index returned 6% on a price-only basis in the first quarter and 7.1% on a total return basis (including dividends). All stock figures, except where noted, are price only.

In the 12 months ended March 31, the interest-sensitive sector gained 18.3% in price, compared with 13.2% for the S&P 500. The index had total return of 18.1% in this period.

Energy stocks were the second-best performing sector in the three months, gaining 8.1%. For the 12 months, they were up 8.5%. The sector includes domestic and international oil companies and oil service and equipment companies.

Stocks sensitive to consumer spending gained 8% in the quarter. These stocks, which are in food and beverage, tobacco, media, retail, lodging and restaurant companies, gained 20.9% in the 12 months.

Basic industry stocks gained 3.8% in the quarter and 9.8% for the year. This group covers the metals, automotive, transportation and building materials industries.

Technology stocks were last for the quarter, gaining 2.4%. The sector includes aerospace, drug, electronics and office equipment companies. The sector gained 6% for the 12-month period.

The 10 best-performing industries in the quarter were textile products and apparel, up 18.2%; air transportation, up 17%; oil service and equipment, up 16.5%; tobacco, up 14.5%; domestic oil and banks, both up 13.5%; insurance, up 12.8%; beverages, up 12.3%; and aerospace and consumer spending/miscellaneous, both up 12%.

The 10 worst-performing industries were office equipment, down 6.8%; trucking, down 6.7%; automotive — cars and trucks, down 1.9%; electronics, down 1%; electric utilities, down 0.8%; electric equipment, up 0.2%; general machinery, up 0.7%; paper, up 1%; consumer durables, up 1%; and auto parts and accessories, up 1.5%.

The top 10 individual stocks were **Pan Am Corp.**, up 116.7%; **Texas Eastern Corp.**, up 81.3%; **Coleman Co. Inc.**, up 79.8%; **NWA Inc.**, up 64%; **Tonka Corp.**, up 60%; **Emery Air Freight Corp.**, up 55%; **Champion Spark Plug Co.**, up 54.2%; **Beverly Enterprises Inc.**, up 44%; **BankAmerica Corp.**, up 38.3%; and **Handleman Co.**, up 37.3%.

In addition to looking at the market by economic sectors, DeMarche analyzes stock performance by quality, growth and yield. As ranked by quality, based on several balance sheet variables, stocks rated average had the quarter's best gain, 7.3%.

As ranked by growth characteristics, stocks with low growth had the best return, 8.4%. As categorized by yield, stocks in the third yield quartile gained the most, 7.3%.

In the bond market, Yankee and foreign issues were the best economic sector, returning 1.6% in the quarter. DeMarche's Pension Fund Bond Index of more than 6,000 issues returned 1%. All bond figures are total return.

Yankee and foreign bonds returned 6.8% in the year ended March 31, while the index had 6.2%.

Utility and U.S. government bonds each were up 1.1% in the quarter. Utilities returned 7% for the year, while governments gained 6.1%.

Bonds in the industrial, financial and telephone sectors all returned 1% for the quarter. For the 12-month period, industrials gained 6.2%; financial issues, 5.7%; and telephone bonds, 5.4%.

Canadian bonds had the quarter's poorest return, 0.8%. For the year, they returned 6.3%.

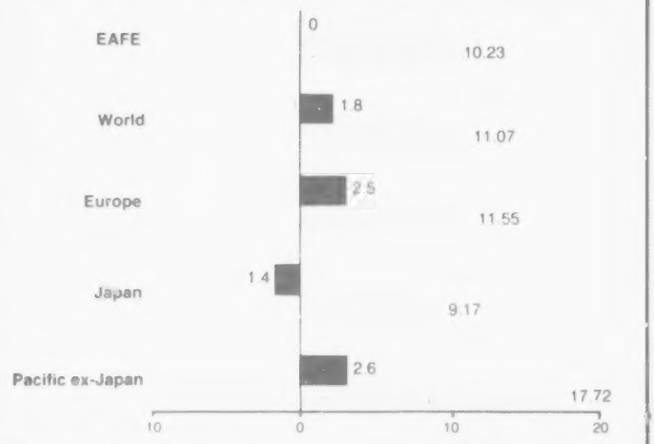
As ranked by quality, bonds rated BAA and AAA performed slightly better than other sectors, with each returning 1.1% in the quarter, compared with 1.1% for AA and A bonds.

Bonds with maturities of 10 to 20 years and 20 years or more both returned 1.1% in the quarter, compared with 0.9% for those with maturities of five to 10 years and 1% for those with maturities of one to five years.

As measured by quality and maturity combined, bonds rated BAA with maturities of 20 years or more had the quarter's best return, 1.7%. ■

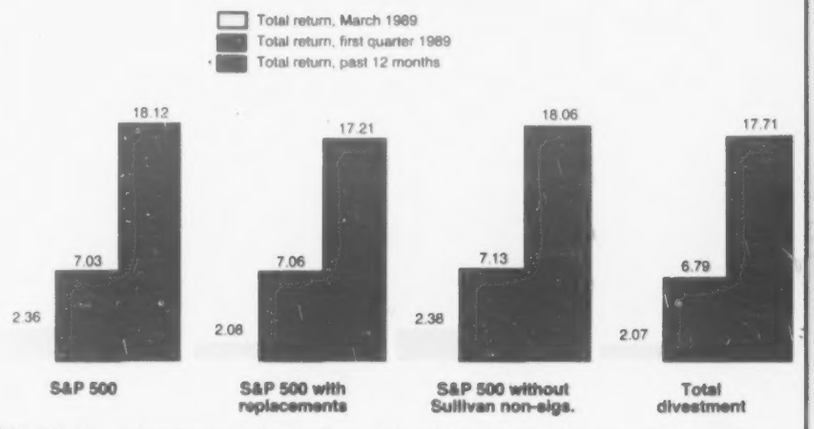
STATISTICALLY SPEAKING

Morgan Stanley Capital International worldwide indexes



Source: Morgan Stanley Capital International, New York
Indexes are in U.S. dollar terms without dividends reinvested

South Africa Free Index



S&P 500 with replacements: replaces a South Africa-related company with next largest company in the industry. **S&P 500 without Sullivan non-signatories:** excludes 6 companies, no replacements. **Total divestment:** eliminates all companies with South Africa involvement, no replacements.

Source: Wilshire Associates, Santa Monica, Calif.

Multiple Markets Index

The Multiple Markets Index is a benchmark for total portfolio returns. It is composed of eight asset classes used by retirement plan executives; it is calibrated to reflect the same degree of risk of the typical pension portfolio; it uses passive fixed policy weights; and it represents the individual asset classes by the broadest and most complete market return data available.

Weights	
Large cap stocks	28%
Small cap stocks	12
International stocks	15
Venture capital	5
Domestic bonds	18
International $ bonds	2
Non-dollar bonds	5
Real estate (equity)	15
T-bills	0
	100%

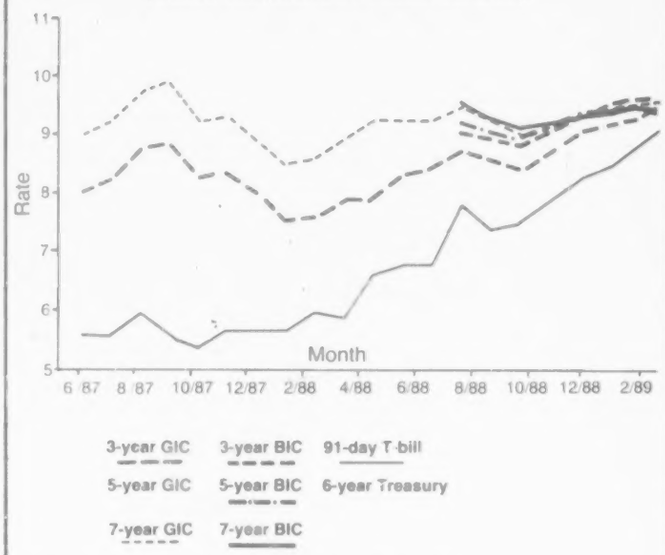
Five-year annualized return	16.1%
One-year return	11.1%
Latest quarter	3.5%

12/31/69 = 100 Data through 3/31/89

Source: First Chicago Investment Advisors, Chicago

Summary of average GIC & BIC data vs. market yields

(Bullet, compound $1 million contract)



Source: William M. Mercer Meidinger Hansen Asset Planning Inc.

First quarter 1989 returns

	Russell 3000®	Russell 1000®	Russell 1000® by market capitalization				Russell 2000®
			Large	Medium/large	Medium	Medium/small	
Technology	-1.3%	-1.5%	-3.6%	-0.1%	2.3%	3.2%	0.7%
Health care	10.1	10.2	9.7	12.5	8.9	8.4	9.7
Consumer discretionary	9.4	8.9	6.1	9.7	8.6	11.1	12.4
Consumer staples	9.3	9.3	12.5	5.5	6.5	2.3	10.3
Integrated oils	7.8	7.7	6.9	14.4	14.8	7.1	47.7
Other energy	12.6	11.6	NA	12.2	11.2	10	20.2
Materials and processing	6.6	6.9	11.3	7.9	4.8	5.9	4.7
Producer durables	7	7.2	11.2	4.4	11.1	4.6	5.9
Auto and transportation	3.9	3.5	-0.4	3.4	6.9	9.9	9.2
Financial services	12.7	13.2	17.5	15.3	12	9.7	6.4
Utilities	6.7	6.8	9.6	5.7	2.1	6.6	3.9
Total	7.3	7.2	6.6	7.5	7.5	8	7.7

Source: Frank Russell Co., Tacoma, Wash.

Fixed income

Continued from page 3

● The ability to predict index returns is primarily a function of predicting interest rate changes.

● The benefits of passive investing can be achieved without indexing by establishing a maturity/duration objective appropriate for the portfolio.

Of the four major index groups, the Shearson Lehman Hutton Government/Corporate has evolved into the dominant index, largely because it was first and because users claim Shearson provides more detailed, useful and timely data, even though investment specialists find the other major indexes of equal quality.

While most investors and bond managers defend the use of the various indexes, many claim they do not accurately represent the fixed-income market.

Ed Bedrosian, chairman of Merganser Capital Management Corp., Cambridge, Mass., said bond indexes are poorer at representation than are equity indexes.

"There is no index which represents the fixed-income market. In equities, you have about 5,000 stocks with 500 representing a fair weighting. The universe is fairly well defined. The fixed-income universe is a diverse and changing universe . . . with new sectors being created all the time," said Mr. Bedrosian.

"If you are doing passive investing with an index, you literally have to change the index to the point where you have to wonder if you are passive anymore," he said. To outperform the indexes, active managers like Merganser must seek out fixed-income instruments that might not be included in the major indexes "before they become popular," he said.

Notre Dame's Mr. Reilly said there is an 85% to 90% overlap in the securities included in the major composite indexes. "That's why when people are looking at one index or the other they look for non-economic items; you're looking for minor details that may make a difference. They are all very comparable."

One bond manager, Rebecca Garner, vice president of Amherst Investment Management, Springfield, Mass., said she does not use any index.

"People peg themselves to an index, they don't just follow it. I don't even think about it. It's never brought up. I have a real problem with wanting to be average and pay myself to be average. Any index is average and that's what these managers are shooting for," she said.

But she acknowledged the Shearson Lehman Hutton indexes are widely used because "you do need some average to know what the market did. Shearson is easy to use because they publish an exact breakdown of the index on a timely basis."

Philip J. Schneider, head of the U.S. consulting practice for Wyatt Asset Services Inc., Chicago, said each index has advantages, but pension executives and bond managers choose an index based on their own investment guidelines.

"We look at the objectives of the fund and use an appropriate index consistent with that. If you can't buy low-quality bonds or corporates and restrict the maturity, there is no sense in using the Salomon Large Pension Fund Index," Mr. Schneider said.

The average maturity of the Merrill Lynch index is 9.4 years; the Ryan index, 8.14 years; the Shearson Lehman Hutton government/corporate, 9.6 years; and the Salomon large pension index, 14 years.

The average maturity of the Salomon index, he said, "is longer than any pension fund or pension fund fixed-income manager. The Salomon pension fund index hasn't really caught on because it is not reflective of the market."

Virginia Henneberry, first vice president at Shearson Lehman Hutton, acknowledged there are only slight differences between the Shearson Aggregate and the Salomon BIG because both cover the government, corporate and mortgage-backed securities sectors. But, she said, "given that, it comes down to service and frequency and the amount of information available in a manageable form to managers and clients."

Nancy Goerdel, deputy director-investments at the Employees Retirement System of Texas, which runs a $3.8 billion fixed-income portfolio internally, said the system uses the Shearson Aggregate Index to measure performance "because it is the best benchmark we can find" and most accurately represents the system's fixed-income portfolio.

"We don't use it to tell us what to do in portfolio management. Investment decisions are based on our advisers and what we see in interest rates. The aggregate is not all-encompassing; it is not the entire market, but it is a fairly good yardstick of the direction of the market. That's why you have these various indexes," Ms. Goerdel said. ■

International

Continued from page 3

to use the EAFE Index both actively and passively. Active managers use it as a benchmark; the bulk of passive managers continue to be indexed to EAFE."

Ted Roman, a vice president at Goldman, conservatively estimates the FT-Actuaries World Indices are used for about $4 billion in passive or quantitative strategies. Michael Mahaffy, a Salomon Brothers international portfolio specialist, estimated the Salomon-Russell series is being used for more than $1 billion in passive strategies.

The EAFE, FT-Actuaries World Indices and the Salomon-Russell series of indexes have similarities as well as differences. Money managers point out all three have been showing relatively similar returns, and they all use market-capitalization weightings.

The competitors, not surprisingly, are quick to cite ways they shine. For instance, the producers of the FT-Actuaries World and Salomon-Russell indexes both insist their indexes contain only stocks available to foreigners.

Apparently in response to investor criticisms of the 18-country, 1,021-stock EAFE index, Mr. Sladkus said Morgan Stanley launched an EAFE (Free) Index in 1987 that excludes 25 stocks not available for purchase by foreign investors.

Another plus of the FT-Actuaries indexes, according to Goldman's Mr. Roman, is the breadth of the 2,500-stock FT, making it the largest, and he believes, most flexible representative of equity markets.

Peter Warrington, the London-based sales and marketing director for The WM Co., agreed, saying the FT-Actuaries World Index "is more representative because it has more stocks in it."

In January, WM, Edinburgh, Scotland, began recommending to its 1,832 pension fund clients — which officials put at three-quarters of the U.K. pension industry — that they peg their accounts to the FT-Actuaries indexes.

The Salomon-Russell offerings began with the Primary Market Index series of 600 non-U.S. securities. It subsequently expanded to include the Extended Market Index of 1,087 stocks and the Broad Market Index of 1,687 stocks.

The PMI is composed of large-capitalization and highly liquid stocks; the EMI includes small- and medium-capitalized stocks; and the BMI, a combination of the PMI and EMI, covers 80% of the world's stock market capitalization.

Salomon-Russell's creators tout that, among other attractions, their product has lower transaction costs than competitors'. A 1988 study by one unidentified institution not connected with either Salomon or Russell showed the cost of investing a $100 million international equity portfolio was 1.28% for the Salomon-Russell PMI index, 1.45% for the EAFE and 1.79% for the FT-Actuaries World Index. Apparently, the liquidity of the Salomon-Russell index helped curb trading costs.

The EAFE, however, is not without charms — one of which is its age. Observers laud EAFE's historical data, which date back at least 20 years. Other pluses include Morgan Stanley's wide dissemination of information about its index. Indeed, "most pension funds decided to go into international investing based on Morgan Stanley's studies" of international markets, said Richard Vella, vice president of Bankers Trust Co. — Investment Management Group, New York.

But no conclusion needs to be drawn about the basic indexing products. These days, index vendors offer practically any variation of the basic product, including changing the way the markets are weighted. Indexes can be weighted by countries' gross domestic product, simple equal weighting or according to some optimized set of expectations on volatilities, correlations with other countries and country-specific returns, said David Umstead, managing director of Boston International Advisors Inc.

"Virtually all our clients who hired us for passive strategies are using a GDP-weighted index," Mr. Umstead said. "It's a much better index for determining country allocations because it's much more diversified (than capitalization-weighted indexes) in how it spreads out money between countries." For instance, the "GDP-weighted index allocates about 35% to Japan, compared with EAFE's about 65% Japan weighting."

GTE Investment Management Co., Stamford, Conn., is using a GDP-weighted benchmark developed by Goldman, Sachs, said Pamela McCann, vice president of GTE Investment Management. The firm runs a total of $1.2 billion in international equities, of which $203 million is passive.

In the end, money managers say there is room for more than one international equity index. As Larry Martin, vice president at State Street Bank and Trust Co., Boston, pointed out, "there are many indexes of the U.S. market."

And for pension funds, there may not be much difference. WM's Mr. Warrington said, "it almost doesn't matter what index" a pension fund uses. In his view, indexes are useful for obtaining quick evaluations after a period ends. "But we advise clients to compare their performances against a universe (of pension funds) rather than an index." ■

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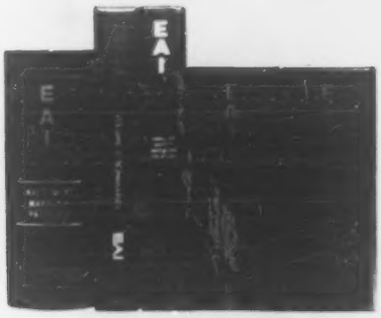

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6 management firms acquired in 1st quarter

By Marlene Givant Star

NEW YORK — Acquisitions and divestitures of asset management businesses soared during the first quarter as financial service companies took a more focused look at their businesses and balance sheets.

Six acquisitions were announced or completed during the first quarter; the same number as the deals completed in all of 1988.

In addition, Primerica Corp., Greenwich, Conn., has announced since the end of the quarter it might increase its already significant share in American Capital Management & Research, Houston. The company owns 83% of American Capital through Primerica's Associated Madison Cos. subsidiary, Templeton, Galbraith & Hansberger Ltd., Fort Lauderdale, Fla., owns 10%.

Batterymarch Financial Management, Boston, also announced since the end of the quarter it would acquire AgriVest Inc., a Glastonbury, Conn.-based manager of agricultural lands. AgriVest manages $325 million in taxable assets; terms of the transaction were not disclosed (*Pensions & Investment Age*, April 3).

Also, The Criterion Group Inc., Houston, with $10 billion under management, announced last month it will become a direct subsidiary of Transamerica Corp., the San Francisco insurance and financial services company in a planned $94.3 million cash offer (*P&I Age*, April 17).

Acquisitions of asset management firms announced or completed during the first quarter were:

- the purchase of J & W Seligman & Co. Inc., New York, which has $6.7 billion under management, in a leveraged buy-out by a group of Seligman directors for $53 million, or 0.8% of assets managed;
- the announcement that United Services Advisors Inc., San Antonio, Texas, which had signed a letter of intent to be acquired by Fred Alger Asset Management Inc., San Francisco, continues to seek a buyer after discussions with Alger were terminated;
- Chicago-based Duff & Phelps Investment Management Co.'s acquisition by Freeman Spogli & Co., a Los Angeles-based merchant bank and manager in a leveraged buy-out for $146.2 million or about 2% of the approximately $7 billion under management, including $5.7 billion in tax-exempt assets; and
- United Asset Management, Boston, announced it was acquiring Dewey Square Investors, Boston; HT Investors Inc., Providence, R.I.; and The Campbell Group Inc., Portland, Ore.

Dewey Square and HT are being acquired from the Bank of Boston for an estimated $20 million to $30 million or roughly 0.6% of their combined $4 billion in assets. The Campbell Group is a timber real estate and forestry investment adviser with $165 million under management. Details of that sale weren't disclosed.

The increased restructuring activity is a healthy sign for both the mutual fund and pension management industry, Dean P. Eberling, vice president and industry analyst at Shearson Lehman Hutton Inc., said in an interview.

"In the past year and a half the bottom didn't fall out of the asset management business," said Mr. Eberling, who recently wrote a report recommending several stocks of asset management companies based on fundamentals and the heady pace of acquisitions and divestitures.

In the mutual fund industry, which is positioned to benefit from the current interest rate environment and the growing uncertainty surrounding the thrift industry, net redemptions of equity mutual funds since Oct. 19, 1987, were offset by money market and high-yield bond fund sales, he said.

Mutual fund assets totaled $836.6 billion at the end of January, just more than 1% below the peak of $848.3 billion set in August 1987, according to the Investment Co. Institute, Washington.

Pension fund management will get a boost from the growth in pension liabilities and decline in plan reversions last year. Although many plans are overfunded, "there will be a crossover where liability growth will outpace financial market returns," increasing the need for strong investment performance, Mr. Eberling said in the interview.

Forty-one terminations of private defined benefit plans with asset reversions in excess of $1 million each were pending as of Sept. 30, according to Employee Benefit Research Institute tabulations based on data from the Pension Benefit Guaranty Corp., both of Washington. The plans represent total assets of $316 million.

In comparison, in 1985 at the height of termination fever, 584 plans were terminated representing $15.1 billion in assets.

"Pension money to be managed is not drying up and post-retirement benefits estimated at $100 billion to $2 trillion represent a huge potential corporate liability to be funded. The investment counseling business is poised to (help) do it," he said.

Prices paid for firms acquired during the quarter ranged widely but were within a cash flow multiple of six to eight, which is average for the industry, Mr. Eberling said.

Among divestitures announced during the first quarter, Aetna Life Insurance Co., Hartford, Conn., announced it was selling Federated Investors Inc., Pittsburgh, with $38 billion under management, for $380 million in a management-led leveraged buy-out. Shearson Lehman Hutton made public it was selling Lehman Management Co., New York, with $17.5 billion under management.

"As companies rationalize their businesses and/or balance sheets, the values embedded in their asset management subsidiaries will make the Aetna and Shearson moves more than just isolated cases," Mr. Eberling's report said.

For many banks, selling asset management firms provides cash to ease the burden of loans to less developed countries and to meet other capital requirements.

Of course, divesting an investment management business is not the right strategy for every financial services firm.

"There are firms heavily in the transaction business, where revenue comes in great lumps, but doesn't maintain a sort of continuous stream. Those firms might well seek to have a less high return but more stable source of revenue," which can be achieved through an investment management arm, said Gerald Rosenfeld, managing director of Bankers Trust Co., New York, speaking at a *P&I Age* round table discussion on the restructuring of the financial services industry (*P&I Age*, March 20).

"The reason institutions typically exit the management business is because money management companies have almost no equity base to them. When you sell, you get huge gains," Steve Schwarzmann, president of the Blackstone Group, New York, said at the round table.

Even if acquisition/divestiture activity slows, asset management firms should fare well; assets under management are increasing industrywide and earnings momentum for the group is becoming solidly positive, the Shearson report said. Shearson expects earnings estimates will rise over 1989 and into 1990. ■

Asset managers' fundamentals get better all the time

	1988	1987	1986
		$ millions	
American Capital M&R			
total revenue	99.2	105.6	112.4
net income	23.3	24.6	26.2
Dreyfus			
total revenue	267.8	275.1	295.3
net income	90.9	94.8	101.8
Franklin Resources'			
total revenue	202.6	243.7	258.2
net income	66.3	74.5	78.4
Oppenheimer Capital²			
total revenue	58.8	64.5	70.7
net income	35.2	34.4	36.8
Pioneer Group			
total revenue	55.1	55.6	58.7
net income	13.8	12.8	13.5
T. Rowe Price			
total revenue	142.2	152.5	158.1
net income	26.6	24.4	25.1
United Asset Mgmt.³			
total revenue	122.4	137.6	146.7
net income	12.1	15.4	17.6

¹ Fiscal year ended Sept. 30
² Fiscal year ended April 30
³ Includes acquisitions of Dewey Square and HT Investors
Source: Shearson Lehman Hutton

Valuations of asset management companies have increased based on their improving fundamentals and heightened acquisition and divestiture activity.

CFOs' salaries

Continued from page 1

vice president, chief financial officer and director of Boeing Co., $617,855.

Although the bosses of the three most highly paid financial officers earned about twice as much as their financial executives, they didn't rank at the top of their pay scale.

The highest paid top executive among the group of 54 was William Jovanovich, chairman and chief executive officer of Harcourt Brace Jovanovich Inc., who earned $2.9 million. The second highest paid was Don Tyson, chairman and chief executive officer of Tyson Foods Inc., whose salary was $2.56 million.

By comparison, William Schreyer, chairman and chief executive officer of Merrill Lynch, was paid $2.5 million; Rand Araskog, ITT chairman and chief executive officer, earned $2.2 million; and Allen Murray, director, chairman, president and chief executive officer of Mobil, earned $1.6 million.

The ratio held true for the lowest paid financial executive as well. John Linehan, senior vice president and chief financial officer at Kerr-McGee Corp., earned $186,963, while his boss — Chairman and Chief Executive Officer F.A. McPherson — earned more than twice as much at $420,773.

Headhunters and executive compensation experts said millionaire chief financial officers are unusual, but they expect to see more as the prestige of the executives rise.

David Smith, managing director at Korn Ferry International, a leading executive search firm based in New York, said the compensation and duties of the chief financial officer have risen significantly in recent years.

"There will probably be a growing number of million-dollar CFOs," said Walton Winder, vice president, Towers, Perrin, Forster & Crosby Inc., New York.

"In the face of all the corporate restructuring and the increasing complexity of the global financial markets, one would have to say that we are in an environment where the CFO has become an increasingly critical function for most corporations. It is the CFO . . . who will be accountable to the CEO for the health of the corporation . . . take the heat . . . and wring more value for the shareholder."

Executives of leading executive compensation and recruiting firms said more chief financial officers are among the top five most highly compensated executives this year than in the past. Also, more hold several key titles, including vice chairman, director and chief administrative officer.

Several studies also bear out the growing importance of the financial executive. One study by Business International Corp. and KPMG Peat Marwick, both of New York, found the executives are having greater influence over operating decisions and are increasingly working in areas outside of traditional finance.

Another trend is the increased use of long-term incentives, such as stock options and restricted stock, to reward financial executives.

"The long-term, non-salary components of the compensation package have risen significantly for the CFOs of industrial and financial service companies," said Pete Egan, partner at Hewitt Associates, Lincolnshire, Ill. ■

Marlene Givant Star contributed to this story.

Lottery earnings

Continued from page 2

But in the normal pell-mell horse-trading of a legislature's closing days, anything is possible. "You never know what will happen at the last minute," said a House staff member.

"Nothing's been settled. This is a very hot issue right now," said James Snyder, deputy treasurer.

The lottery proposal is opposed by Gov. Evan Bayh, who wants to use the money for infrastructure improvements, although he isn't expected to veto the pension funding proposal if passed.

"The lottery is the first new source of revenue in a long time," Mr. Fox said.

Until now, he said, the state hasn't done anything to fund its pension obligations. "Indiana is encouraging early retirements. Why go into a program and make us even further in the hole if we can't fund our current obligations?"

The $1.5 billion Indiana State Teachers' Retirement Fund is underfunded by about $3.4 billion, and another $2.2 billion in unfunded liabilities comes from various municipal fire and police pension plans that predate the formation of a state consolidated fire and police pension plan in 1977, according to Michael Cherry, acting executive secretary of the $2.9 billion Indiana Public Employees' Retirement Fund.

The employees' fund is funded for current obligations on an actuarial basis, he said.

Mr. Fox's proposal conflicts with the plan of Mr. Bayh, who wants to use 25% of the lottery revenue for a local revenue-sharing program, but nothing for pension funding. The balance initially would be used for sorely needed infrastructure improvements throughout the state, according to Mr. Bayh's press secretary, Fred Nation.

Estimates of lottery net revenue — gleaned from neighboring Kentucky's initial experience — vary. The first year, assuming only four months of operation, estimates range from $48.6 million to $80 million; the second fiscal year (July 1, 1990 to June 30, 1991) has estimates ranging from $97 million to $195 million.

If the bill becomes law, it is anticipated the state will have instant lottery tickets available Sept. 1 and a jackpot lottery beginning in 1990. Indiana's neighbors — Ohio, Michigan, Illinois and Kentucky — have lotteries.

Robert Newland, chief financial officer for the $1.5 billion Indiana State Teachers Retirement Fund, said the fund has been a "pay-as-you-go" system for at least two decades; every month the state makes the annuity purchases for its retiring teachers.

"Literally, every month I walk over to the treasurer's office and tell him we need $16.5 million for our annuity purchases," Mr. Newland said.

"The lottery proposal is quite novel," he said. "It's quite a door opening for Indiana to consider it."

Mr. Cherry said the underfunded municipal police and fire plans currently receive about $35 million per year from cigarette and alcohol taxes that were instituted in 1977.

State legislators also are considering a second try at a constitutional amendment allowing the state pension funds to invest in equities. In 1986, voters defeated the proposal 51% to 49%, according to Mr. Nation. ■